



Analyst

Liang Shibin
+6565311516
liangsb@phillip.com.sg

The Ringing of The Siren, Hear That?

Executive Summary

- **Equities – Investors may have to live with exaggerated price movements at the very moment; It is advisable to stay low and not chase short-term price changes.**
- **Commodities – The overall uptrend will remain intact for gold commodity; Level at US\$1550/Oz. offers good risk reward opportunity for the medium to long term investors.**
- **Fixed Income – The possibility of a disorderly credit event triggered by Greece is still in the pipeline as the country may run out of cash by end-October.**

Equities – Bear(ing) the Fall

“Significant downside risks” is the new reality in the stock markets today. The month of September was no better from August as the MSCI AC World Index of 45 nations continued to sink into a bear market for the first time in more than two years. According to Bloomberg data, worsening European debt crisis and threat of a U.S. recession have erased more than \$10 trillion from equities since May.

During the month, the Fed announced its pessimistic reading of the economy plus its widely anticipated “Operation Twist” strategy of shifting its Treasury purchases from short to the long end. Market reacted negatively and the plunge continues.

Over the one month period, major equity markets headed down while Information Technology and Indian equities outperformed. Information Technology equities remain one of the most resilient sector over three-month and six-month period, down 2.6 percent and 7.3 percent respectively. Thailand and Indonesia equities took a hit of about 9 percent from a month-on-month basis. Over the past six-month period, European equities were the worst performer, down 24.6 percent.

Table 1: Selected Equity Stock Market Index Returns

Country	Index	Sept. 28	1-mth % gain/loss	3-mth % gain/loss	6-mth % gain/loss	52 week High	52 week Low
India	BSE Sensex 30 Index	16524.03	4.26 ▲	-10.26 ▼	-12.18 ▼	21108.64	15765.53
Information Tech	MSCI Information Technology	84.54	3.11 ▲	-2.64 ▼	-7.34 ▼	96.73	77.55
Europe	Euro Stoxx 50 Pr	2194.03	0.16 ▲	-19.45 ▼	-24.64 ▼	3077.24	1935.89
United States	S&P 500 Index	1175.38	-0.12 ▼	-8.18 ▼	-10.54 ▼	1370.58	1101.54
Singapore	Straits Times Index	2725.91	-0.81 ▼	-10.65 ▼	-10.84 ▼	3313.61	2627.24
Japan	Nikkei 225	8624.33	-1.97 ▼	-10.62 ▼	-9.01 ▼	10891.60	8227.63
Malaysia	FTSE Bursa Malaysia KLCI	1364.20	-5.58 ▼	-13.11 ▼	-9.91 ▼	1597.08	1310.53
China	Shanghai Composite	2415.05	-7.55 ▼	-12.47 ▼	-19.07 ▼	3186.72	2384.64
Thailand	Stock Exchange of Thai Index	946.62	-8.73 ▼	-6.60 ▼	-8.36 ▼	1148.28	867.86
Indonesia	Jakarta Composite	3473.94	-9.57 ▼	-9.30 ▼	-3.58 ▼	4195.72	3217.95

Major equity markets headed down while Information Technology and Indian equities outperformed.

Source: Bloomberg, as of 28 Sept 2011



Global Equities – The 2008 Experience

As mentioned in our previous report, the preceding fall among global equities will be followed by a series of dead cat bounces. So far, September was a month of wild market swings, trending to the downside. The last time we have such a volatile market was back in Oct-2008. (See Chart 1 below)

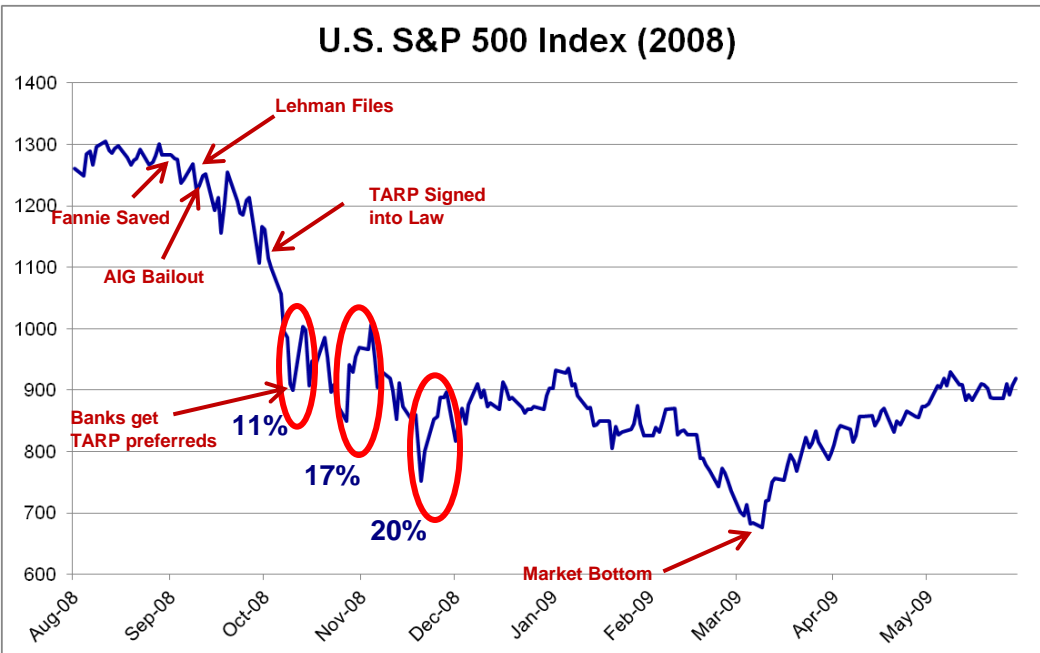
In 2008, equities were experiencing wild daily swings as a series of announcements and events were being played out. Daily market actions were dominated by short term intraday market events rather than the longer term structural problem. Today, the ongoing structural problem lies with the European debt burden. This problem requires more than just a few positive bailout talks to be resolved. With the 2008 experience in mind, we feel that investors should continue to stay low and not chase short-term price changes.

The 2008 experience also cast some attention on the high level of correlation among equities. Equities tend to move together in a downward spiral when markets are driven by fear. According to the Financial Times, the recent correlation between the movement of big U.S. stocks stood at 81 percent, the highest level since Black Monday in 1987. The historical average is only 30 percent. This period of time will be especially tough to many long-only investors.

Billionaire investor George Soros portrayed that financial markets tend to feed on their own misconceptions about events to produce exaggerated movements, which produce new misperceptions. This two-way feedback between perception and reality is described as theory of 'reflexivity'. As a matter of fact, we may have to live with these exaggerated price movements at the very moment.

Overall, we expect that the correlation and volatility level to stay high relative to historical averages. Investors will be looking to the third quarter earnings season to gauge the company fundamentals and we will reassess the overall picture again then.

Chart 1: 2008 Experience – High Correlation and Volatility Period



Source: Bloomberg, as of 30 Sept 2011

In 2008, equities were experiencing wild daily swings as a series of announcements and events were being played out.



European Equities – Not For The Faint-Hearted

European stocks were down more than 25 percent since May, trading near 30-month lows. With dividend yields among major European stocks standing at 5.5 percent and earnings yields of more than 10 percent, should European stocks deserve another look primarily from a value basis? The answer is probably not yet.

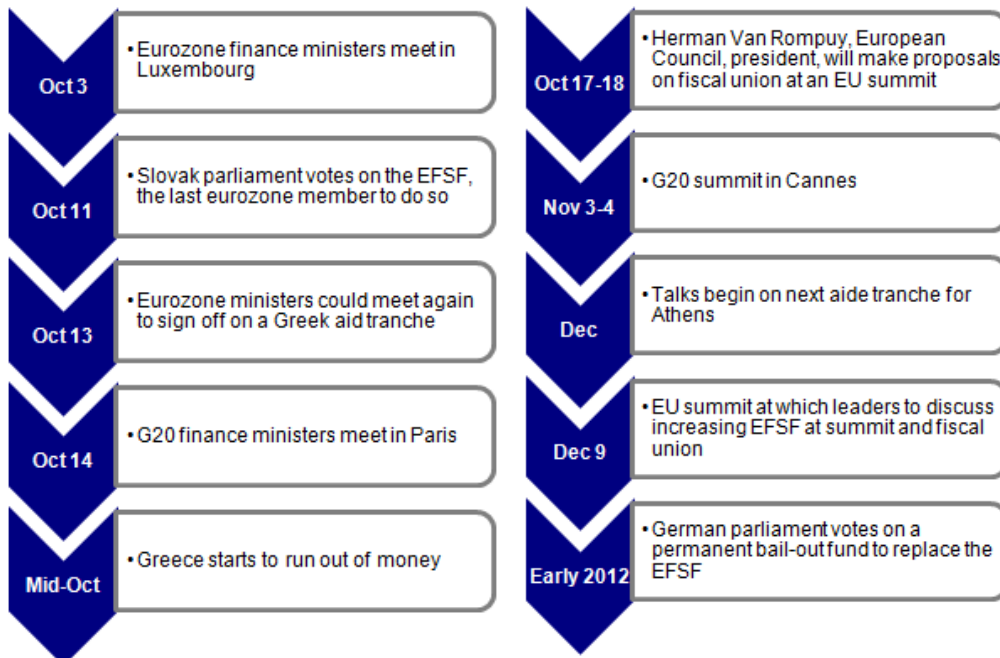
Today, investors remain wary towards making a significant investment in Europe. Investors are waiting for concrete resolution plans towards the crisis before making any commitments. The recent performance of European equities suggested that concerns about growth risks will continue to dominate. Therefore, it will be advisable to stay clear of European equities till we see major resolutions by the policymakers.

In terms of timeline, the month of October will be crucial. According to the Financial Times, the future of Greece and the Euro single currency may be decided as early as this coming October. Eurozone policymakers may have to push through several policies hurriedly in response to the imploding crisis. Proposal for a fiscal union and shared responsibility for sovereign debts are top of the agenda. More importantly, the market expects Greece to run out of money by Mid-October. (See Chart 2 below)

Indeed, the European equities are massively oversold at the moment. We would recommend taking a short term positioning once positive reform talks emerge among the policymakers. On the hindsight, we remain structurally bearish over the longer term outlook. The European political system has proven to be fragmented and controversial. Buy-and-hold or long term investors will face hurdles ahead.

As a guide, the Euro Stoxx 50 has been a substantial underperformer over the past 11 years. The Euro Stoxx 50 Index is down more than 62.4 percent since its peak in 2000. A buy-and-hold strategy would have performed badly.

Chart 2: Timeline of Events Taking Place in the Month of October



Eurozone policymakers may have to push through several policies hurriedly in response to the imploding crisis.

Source: The Financial Times, as of 26 Sept 2011



Gold Commodity – Game Is Not Over Yet

Gold and silver prices were equally volatile as equities in the month of September. Gold fell 12 percent in 3 days to touch US\$1535/Oz. before bouncing back to US\$1620/Oz. shortly. Silver fell 33 percent in 3 days to US\$26.15/Oz., coming off from the US\$40/Oz. level previously.

Although gold and silver have been performing fairly well on a year-to-date basis, palladium and platinum were falling off the cliff, down 22.3 percent and 14.0 percent respectively. Within the precious metals space, we continue to favour gold and silver to outperform. We feel that the recent pullback in gold and silver prices offer good buying opportunities. (See Chart 3 below)

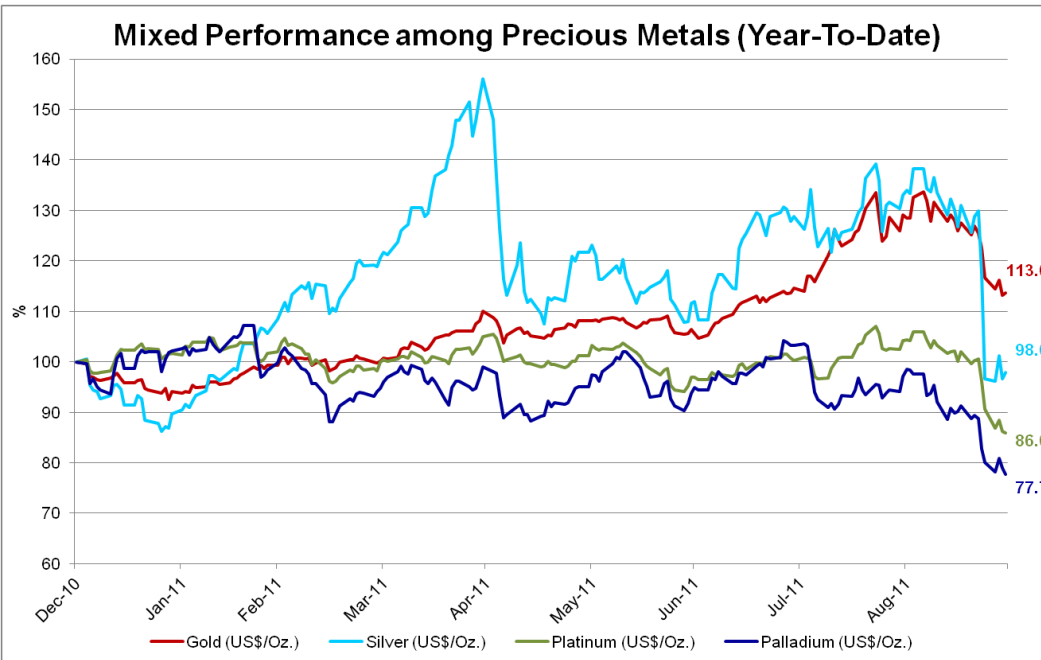
In the context of the macro picture, it is not game over yet for gold and silver commodities. We believe that the safe haven status will continue to be in play for many months (if not years) down the road. In terms of price action, the recent weakness in gold and silver may be the result of a near term rally in the U.S. dollar. However, given the high probability of extraordinary measures from global policymakers to combat the U.S. slowdown and European debt crisis, gold and silver will protect investors against global economic uncertainty ahead.

According to a recent report released from GFMS, gold demand from China and India helped in a 7.5 percent increase in demand for gold jewellery during the first half of the year despite a 25 percent increase in the price. Gold buying in India and China is boosted by the huge wealth creation wave spurred by the two countries' robust economic growth.

Supported by physical demand, we believe that the overall uptrend will remain intact especially for gold commodity. The level at US\$1550/Oz. offers good risk reward opportunity for the medium to long term investors. Near term resistance will be at the previous high of US\$1920/Oz..

Chart 3: Gold and Silver Outperforming Platinum and Palladium

Mixed Performance among Precious Metals (Year-To-Date)



Gold and silver have been performing fairly well on a year-to-date basis while palladium and platinum were falling off the cliff.

Source: Bloomberg, as of 30 Sept 2011



Europe Debt Crisis – Filling A Bucket With Holes

Since the Jul. 21 agreement that includes a second bailout for Greece and an overhaul of the region’s rescue fund, the market turmoil linked to the European debt crisis never stopped.

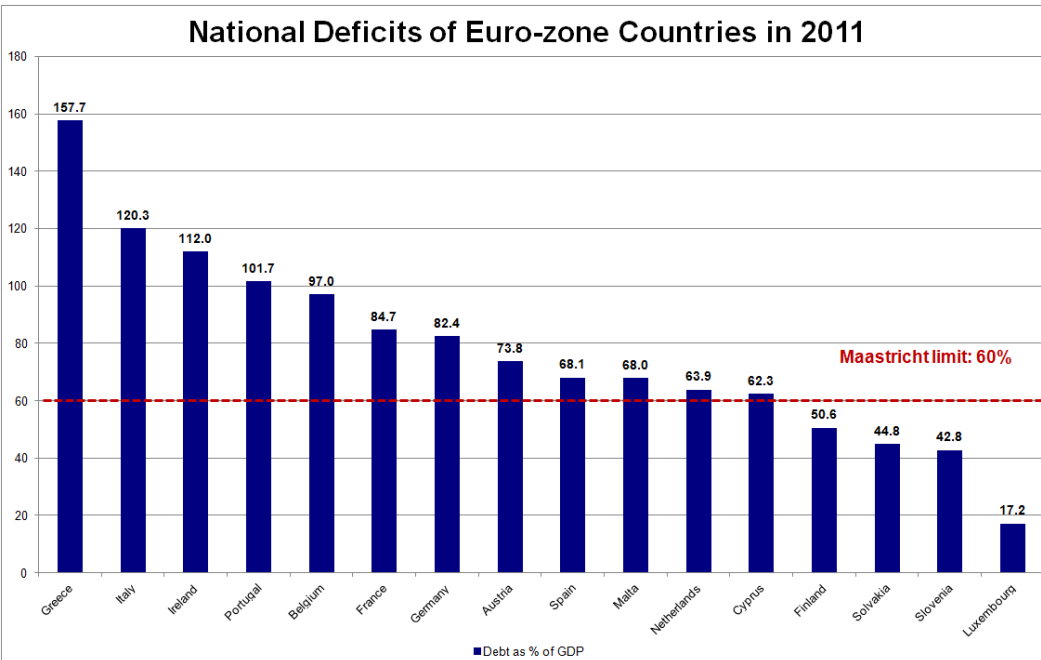
There are clear signs that the Greek government will not meet the requirements in terms of structural reforms and budget performance. The latest data show a 12 percent real GDP contraction for the Greek economy since Q2 2008. This resulted in a structural decline in output. At the same time, a series of hikes in direct and indirect taxation failed to make up for the falling budget revenue. The spending control mechanisms in the country is failing badly.

In terms of deadline, the Eurozone may be facing a full-blown crisis as earlier as October (see page 3). Peripheral nations are finding less breathing space as the days go by. According to a recent Wall Street Journal article, Greece will likely receive the next tranche of assistance by late September. Domestically, the Greek Deputy Minister of Finance stated that Greece has enough cash balances to go through October. Beyond that, the possibility of a disorderly credit event triggered by Greece is still in the pipeline.

To further emphasize, we feel that a bailout will not address the fundamental causes of Greece's fiscal problems. Greece’s economy is built upon an unsustainable model. Misguided policies generated double-digit deficits and a bailout will postpone painful austerity measures to amend its fundamental flaws.

Another round of bailout will mean that Greece will be back for additional bailouts. Other peripheral nations will claim their difficulties as well and seek bailouts. Therefore, we see nothing to cheer about in the event of a Greece bailout. In fact, drawing good resources to fill the debt hole of the peripheral nations is poor policymaking for the future. Nobody is expecting a happy ending in this debacle.

Chart 4: Heavily-Indebted European Nations Exceeding the Maastricht Limit



Source: Eurostat, as of May 2011

A potential bailout will not address the fundamental causes of fiscal problems among the European members.



US Treasury – Just Got Twisted

On Sept. 21, the Federal Open Market Committee increased the duration of its securities holdings by selling US\$400 billion of short maturity securities (3 years or less) and buying longer maturity securities (6-30 years). The move is known as “Operation Twist” for its goal to bend the Treasury yield curve, nudging the longer term interest rates lower. Also, the Fed will reinvest maturing and prepaid agency MBS and agency debt in agency MBS, in a bid to support the housing sector.

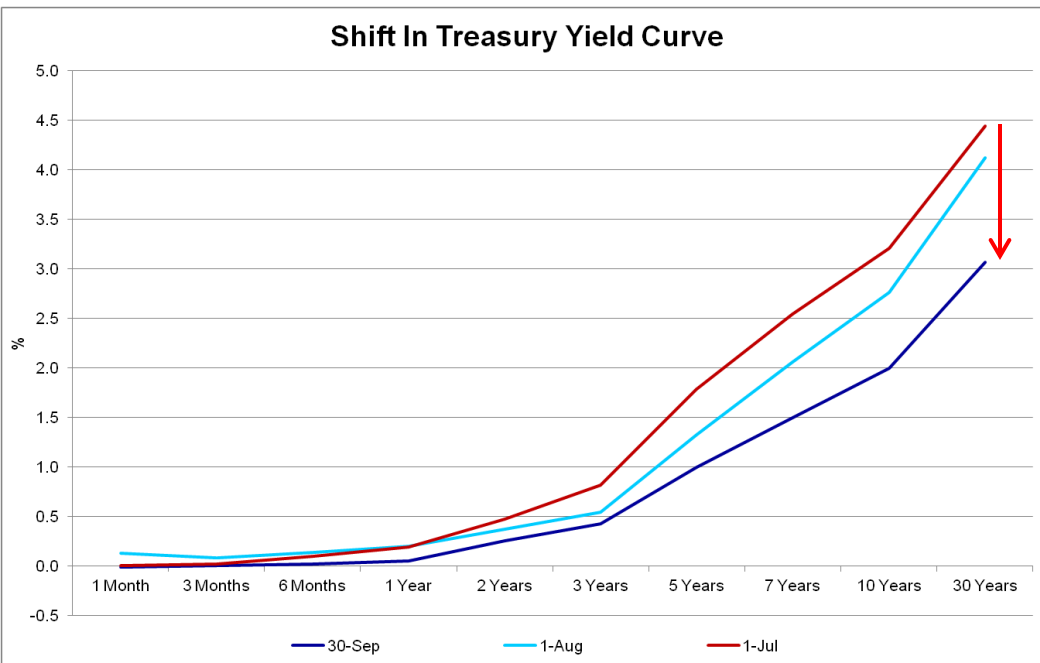
Certainly, the latest round of unconventional monetary easing comes at a time whereby the state of U.S. economy is still weak and economic downside risks are heightening. The Fed had already held the benchmark interest rate near zero since December 2008 and expanded the central bank’s assets in July to a record US\$2.88 trillion. That has done little to boost consumer spending, which accounts for 70 percent of the economy.

In our previous report, we highlighted that the short end of the Treasury yield curve is trading at next to zero yield. The “Operation Twist” is likely to cause short term yields to inch up slightly while causing a larger than proportion drop in the long term yields. This will effectively flatten the Treasury yield curve to a great extent.

Overall, we feel that “Operation Twist” will not result in a big sell off among the short maturity Treasury securities. Higher risk aversion due to sovereign concerns in the Eurozone and potential catastrophic outcome of sovereign default will be the primary drivers for demand of short maturity Treasury securities. We believe that near term default risk is negligible for U.S. Treasury securities and short maturity Treasury securities are going to remain the preferred safe haven play.

At the same time, the long end will benefit through the Fed US\$400 billion purchase. Overall, Treasury yields look set to continue their downward trend over the next few months.

Chart 5: U.S. Treasury Yield Curve Shifts Down (since 01-Jul-2011)



We feel that “Operation Twist” will effectively flatten the Treasury yield curve further, pushing down long end of the curve.

Source: Bloomberg, as of 30 Sept 2011



GENERAL DISCLAIMER

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities Pte Ltd shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

This publication is solely for general information and should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities, and specifically funds, mentioned herein. It does not have any regard to your specific investment objectives, financial situation and any of your particular needs. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of any person or group of persons acting on such information and advice. Unit Trusts distributed by Phillip Securities Pte Ltd are not obligations of, deposits in, or guaranteed by, Phillip Securities Pte Ltd or any of its affiliates. No action should be taken without first viewing the details in a fund's prospectus. A copy of the prospectus can be obtained from Phillip Securities Pte Ltd or online at www.eunittrust.com.sg. Past performance is not necessarily indicative of future returns. Investments in unit trusts are subject to investment risks, including the possible loss of the principal amount invested. Investors should note that the value of the units and income from the fund may rise as well as decline. Investors should also note that there are limitations whenever performance is stated or comparison is made to another unit trust or index for any specific period as no funds or indices are directly comparable.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any investment product described in this material is suitable or appropriate for the recipient. Recipients should be aware that the investment products described in this publication may involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Whilst we have taken all reasonable care to ensure that the information contained in this publication is accurate, we do not guarantee the accuracy or completeness of this publication. Any advice contained in this publication is made only on a general basis and is subject to change without notice. We have not given any consideration to and have not made any investigation of the investment objectives, financial situation or particular needs of any specific person or group of persons as we are not in possession of any such information. You may wish to seek advice from a financial adviser before making a commitment to purchase the investment products mentioned. In the event you choose not to seek advice from a financial adviser, you should consider whether the investment product is suitable for you. Any unit trusts mentioned in this publication is not intended for U.S. citizens.

DISCLOSURE OF INTEREST

Statement pursuant to section 36 of the Financial Advisers Act - Phillip Securities Pte Ltd, its directors and employees may have interest in the securities recommended herein from time to time, and its associates and connected persons may also have positions from time to time. Opinions and views expressed in this report are subject to change without notice.

PhillipCapital is a group of companies who together offer a full range of quality and innovative financial services to retail, corporate and institutional customers. Member companies in Singapore include Phillip Securities Pte Ltd, Phillip Securities Research Pte Ltd, Phillip Financial Pte Ltd, Phillip Futures Pte Ltd, Phillip Trading Pte Ltd, Phillip Capital Management (S) Ltd, CyberQuote Pte Ltd, International Factors (Singapore) Ltd and ECICS Ltd.

Information on any and all independent PhillipCapital members and the respective financial services they offer can be obtained through the following website – www.phillip.com.sg. Members can otherwise be identified by their authorised use of PhillipCapital brand name along with their own name in their documentation and literature.