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Crashing Down, Singapore Government Bonds for Cover

Executive Summary

- Impending debt disaster in Spain and Italy – Turbulent times ahead for the European members with the sovereign debt crisis looking to blow up in a big way.
- Debt ceiling deal is over but the worst is not – In what could be one of the worst sell-off since February 2009, U.S. stocks plunged close to 5 percent in a single trading day on Aug. 4.
- Schroder Singapore Fixed Income Fund – Invests in the Singapore fixed income market through SGD-denominated bonds; 79 percent Singapore government bonds holdings as of Dec-2010.

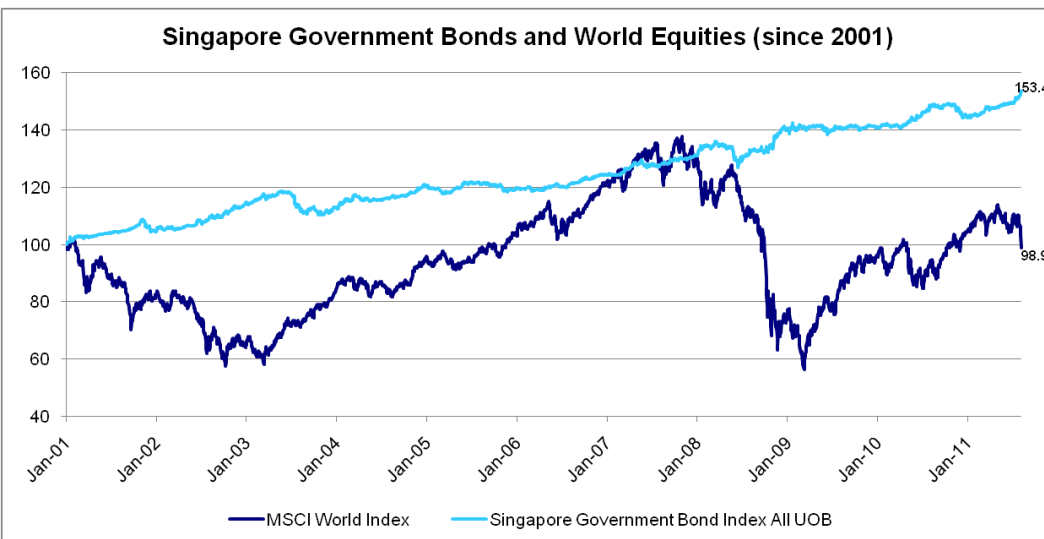
Headline Risks Dominate – Invest Wisely

In what could be one of the worst sell-off since February 2009, U.S. stocks plunged close to 5 percent in a single trading day on Aug. 4. The VIX Index also made a single day surge of 35 percent, the largest since February 2007.

Headline risks were dominant over the past few days with further escalation of the European debt crisis and possible double dip on the U.S. economy. Asian stocks were not spared from the bloodbath and regional indexes are down more than 10 percent from their May peaks.

We feel that Singapore government bonds (also known as SGS) may be good investment options amidst current market chaos. Since Jan-2001, the annualized return on a portfolio of active SGS stood at 4.1 percent. Historically, the SGS have shown great resilience against market turmoil. With concerns surrounding the long term solvency of the U.S., we expect to see fading safe haven demand for U.S. dollar denominated assets. Given that no currency risk is involved, SGS will be an even more appealing option for local investors. (See Chart 1 below)

Chart 1: Picking Singapore Government Bonds as Safe Haven Play



Consistent performance in Singapore government bonds since Jan-2001, with an annual return of 4.1 percent.

Source: Bloomberg, as of 05 Aug 2011



Headline Risk 1: Impending Debt Disaster in Spain and Italy

We mentioned in “Asset Class Update (Aug)” that the 6 percent mark will be crucial for the 10-year sovereign debts in Spain and Italy. On Aug. 2, the 6 percent level was breached. Spanish 10-year government bond yield hit an intraday high at 6.45 percent while the Italy 10-year government bond yield touched 6.25 percent.

We feel that the peripheral nations’ yields will continue to inch higher from here. Italy and Spain are likely to feel the heat. Economic stagnation will stay in Europe and investors should look to eliminate Southern European risk at the moment.

Pressure points are mounting:

1. Deutsche Bank AG reportedly dumped more than €8 billion of government bonds related to the peripheral PIIGS nations. It currently holds €3.67 billion as of June 30, a decline of 70 percent from the previous €12.1 billion.
2. The European Financial Stability Facility has just €275 billion left after pledges to Greece, Ireland, and Portugal. Initial estimates suggested that an additional €2 trillion is necessary to backstop Spain and Italy.
3. Based on estimates from JP Morgan, Italy will run out of cash to cover spending by this September. Together with the recent headwinds, signs of no confidence among investors often lead to a self-fulfilling negative spiral. The FTSE MIB Index plunged more than 25 percent since mid-February.
4. Spain will be in line to run out of cash by February 2012. More worryingly, Spanish banks currently borrow around €100 billion through foreign repo financing and widening of Spanish government bond spreads could create problems for the Spanish banking system. The International Monetary Fund said on Jul. 30 that Spain "is not out of the danger zone".

Table 1: Latest Development Among the European Peripheral Nations

Country	5-year CDS price (bps)	Debt to GDP % (2010)	Latest Unemployment rate	Latest Headlines
Portugal	947	83.2	12.2%	Portuguese bank, Banco Espirito Santo SA anticipates more than €450 million of write-downs on its loan portfolio. Portugal's credit rating was downgraded to Ba2, non-investment grade rating.
Spain	254	63.4	21.0%	Prime Minister Zapatero has called for early elections, a new Spanish government will be elected this November instead of next March.
Italy	315	118.0	8.0%	On Aug. 3, Guilio Tremmonti (Italy's finance minister) held crisis talks with Eurozone chief as Italy face looming meltdown on money markets.
Ireland	821	64.8	14.2%	Moody's cut Ireland to Ba1 from Baa3, the third euro-area nation to have its credit rating reduced to below investment grade. The country's July manufacturing PMI falls to 48.2, weakest in 18 months.
Greece	2499	142.8	15.0%	Greece received a second bailout worth €159 billion on Jul. 21.

Source: UT Research Team and Bloomberg, as of 03 Aug 2011

Turbulent times ahead for the European members with the sovereign debt crisis looking to blow up in a big way.



Headline Risk 2: The Debt Ceiling Deal is Over But the Worst is Not

The debt ceiling deal is over but the worst is not. Deteriorating levels of output, employment, income and not least to mention the housing market in U.S. points to a rather bleak outlook at the moment. Respected economists like Martin Feldstein in recent days stated the odds of a U.S. recession scenario at 50-50 and Larry Summers was slightly more optimistic, putting the odds at 1 out of 3. The U.S. economy is hardly convincing, the Bureau of Economic Analysis estimated that U.S. GDP grew at a very slow 1.3 percent in the second quarter of 2011.

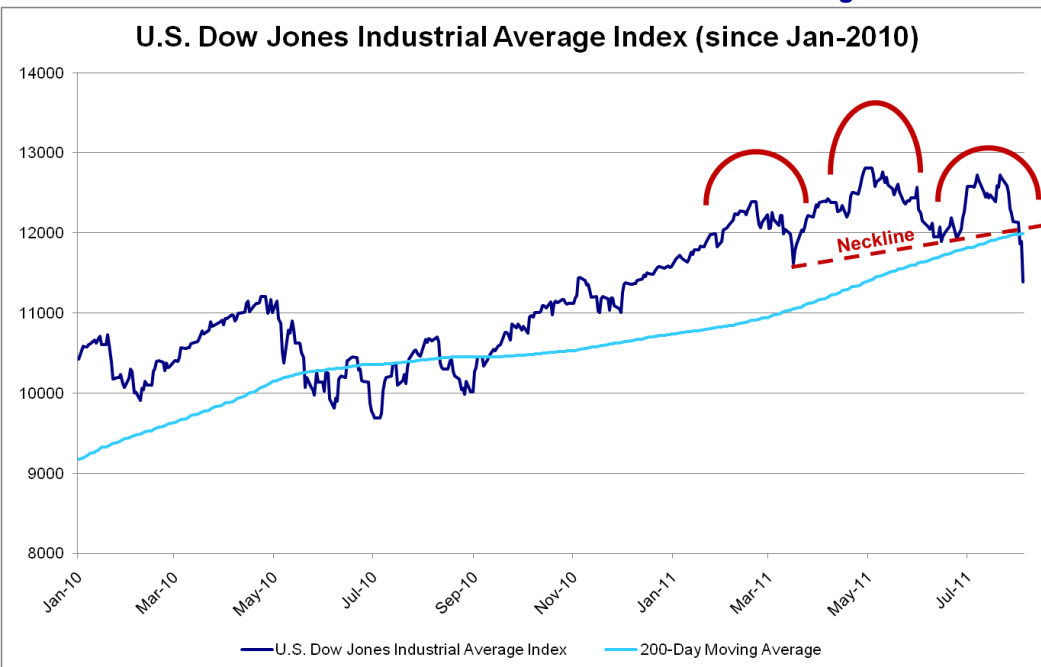
Unless any drastic measures are taken to revive the economy, the U.S. deficits and debt burden are likely to get worsen in the coming decade as the market fears for an ultimate systematic breakdown of the monetary system.

The recent sell-off in risky assets is especially pronounced. The U.S. S&P 500 Index had erased all of this year's gains. The index last traded at its lowest point of the year following eight days of consecutive losses. Historically, the longest losing streak in U.S. markets was 12 days, recorded in 1941 and 1968. Also worryingly, volume was significantly high and expanding on sell-offs. Downside target is at 1150.

Equivalently, the Dow Jones Industrial Average Index has successfully broken the neckline on its Head and Shoulder formation, signalling further downside ahead. To illustrate, the May peak represents the "head" with two "shoulders" forming in July and March. Key support at the daily 200 Moving Average was also taken out. (See Chart 2 below)

Having said that, the U.S. markets are massively oversold at the moment. A near-term bounce cannot be ruled out. However, we remain structurally bearish on the outlook of U.S. equities at the moment. Headline risks associated with the U.S. economy should not be ignored and selling risky assets on rallies looks a rational move.

Chart 2: Broken Neckline on U.S. Dow Jones Industrial Avg Index



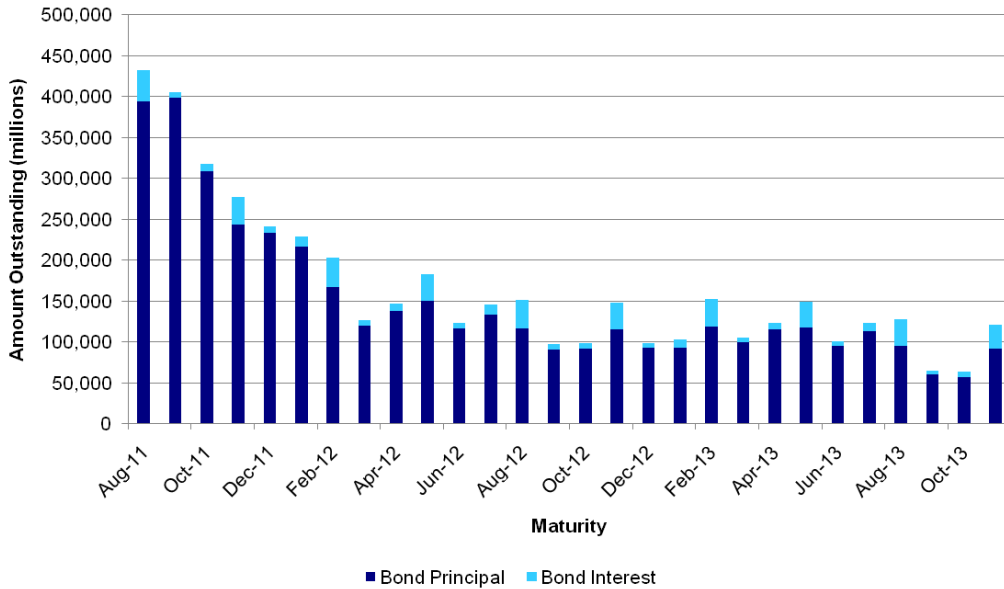
The Dow Jones Industrial Average index broke the Head & Shoulder neckline and daily 200-Day moving average support.

Source: Bloomberg, as of 05 Aug 2011



Chart 3: Indebtedness in U.S. Likely to Persist Through 2013

U.S. Treasury Debt Distribution

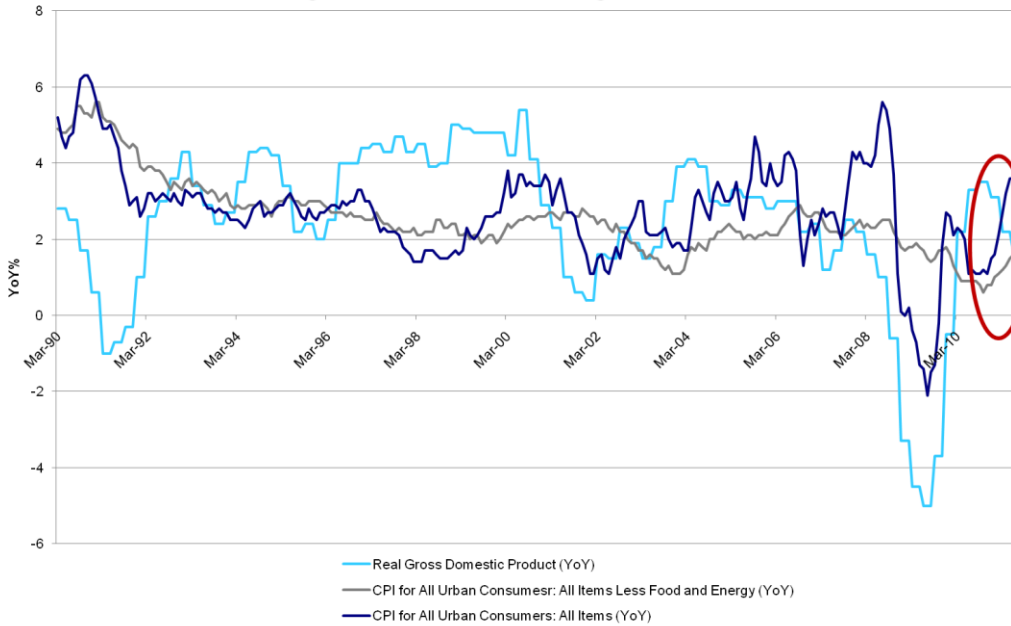


Source: Bloomberg, as of 05 Aug 2011

U.S. government is likely to live with high level of indebtedness through 2013, when a new debt ceiling deal is due.

Chart 4: Decline in U.S. Growth Against a Rising Inflation Backdrop

Declining GDP Growth and Rising Inflation in U.S.



Source: Bloomberg, as of 05 Aug 2011

Declining GDP growth and a rising inflation may put U.S. policymakers on the back foot for further monetary or fiscal stimulus.



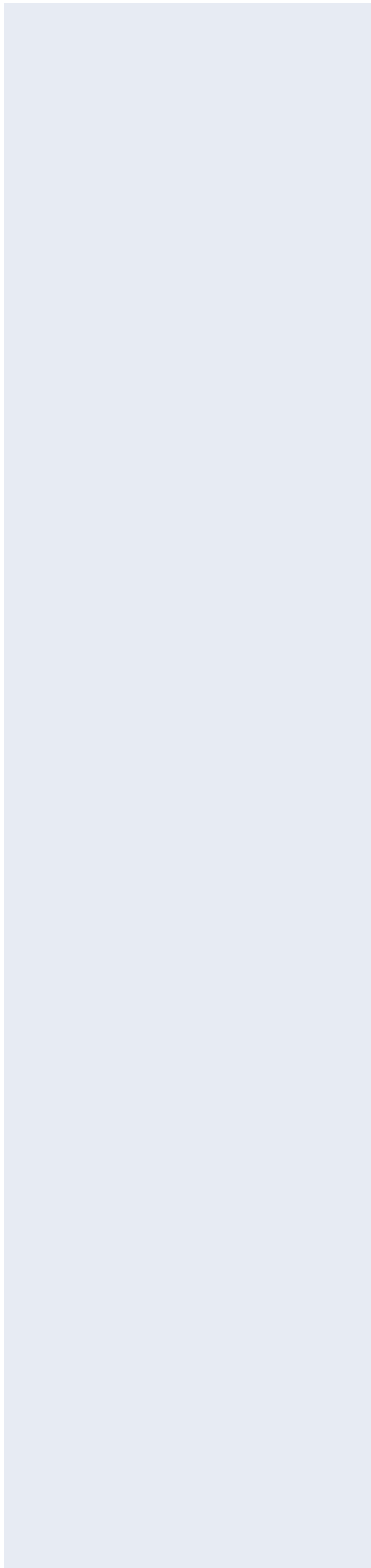
Singapore Government Bonds: What About Them?

SGS are interest-earning debt instruments issued by the Monetary Authority of Singapore on behalf of the Singapore government. These bonds are rated AAA and backed by the full faith and credit of the Singapore government.

Unlike the U.S. or other indebted European Union members, the primary purpose in issuing Singapore government bonds is to establish an efficient and liquid government bond market instead of making up for the country's deficit. The Singapore government also generates healthy surpluses with the help of sound monetary and fiscal policies. Together with the country's massive foreign reserves, we do not expect any near term default risk on Singapore government bonds.

More importantly, we feel that exposure to a portfolio of SGS will help investors to stay resilient amidst the current market chaos. The ongoing headline risks and possible global downturn ahead should prompt investors to reposition their portfolios with capital preservation as the priority. The macro environment today supports the idea of minimizing cyclical exposures and rethink about the usual buy and hold strategy.

Fund in Focus: Schroder Singapore Fixed Income Fund Class A





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