
GLOBAL EQUITY

# Market Commentary

February 2010

| EQUITIES | 1 Mth | 3 Mth | YTD | 12 Mth |
|---|---|---|---|---|
| MSCI AC World | -4.4 | 1.7 | -4.4 | 28.0 |
| MSCI World | -4.2 | 1.6 | -4.2 | 24.1 |
| MSCI USA | -3.6 | 4.2 | -3.6 | 21.4 |
| MSCI Europe | -5.9 | -1.8 | -5.9 | 29.2 |
| MSCI Japan | 1.3 | 1.5 | 1.3 | 6.5 |
| MSCI AC Asia ex-Japan | -6.1 | 0.8 | -6.1 | 55.7 |
| MSCI Emerging Markets | -5.6 | 2.5 | -5.6 | 64.0 |

Returns in Singapore dollars. Source: Bloomberg, 29 January 2010

World equity markets fell in January, with the MSCI AC World Index down 4% in US dollar terms. Asia and Europe posted the larger declines due to the twin concerns of monetary tightening in China, which adversely impacted Asia, and mounting economic and fiscal concerns in Europe centered around Greece and the 'PIGS', an acronym to describe Portugal, Ireland, Greece and Spain, all countries running unsustainable fiscal deficits.

Despite a continuation of broadly favourable economic indicators, investors became concerned as policy direction started to waiver in the face of political pressures along with mounting concerns over public spending and fiscal deficits.

While economic indicators continue to suggest that the broader economy is in the early phase of recovery, public opinion has recently shifted away from supporting longer term objectives in favour of addressing shorter term concerns, namely jobs. The Obama administration responded to this change in the public mood by announcing a shift in spending priorities.

Government spending policies that are clearly unsustainable have also been placed under the microscope by investors, who started to question the financing (re-financing) needs of countries that have been running large deficits and have racked up large debts. Greece has become the poster child of the mounting fiscal challenges faced in the developed world.

Given renewed efforts by China's policy makers to slow down property investment and limit riskier credit expansion, along with broader questions over the strength of the recovery, Asian and Emerging Markets corrected in January, down by 6.1% and 5.6% respectively.

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With the exception of Japan, Developed Markets were also weak. Japan was bolstered by hopes of a global recovery and improving corporate earnings and profitability. The early strength in Japanese equities, buoyed by a firmer yen, reversed in late January. The high profile Toyota Motor recall further weighed on market performance in late January.

European markets fell 6% in January, in US dollar terms. Mounting concerns over public finances along with perceived labor market rigidities, weighed on the outlook for the broader economy and corporate profits. The relative strength of the euro, up until late January, also clouded the profit picture, given upward pressure on unit labor costs. While valuations for the Eurozone are cheap, there are a number of risks to earnings and fewer near term catalysts for the market.

Emerging Markets, which had been a bright spot in terms of performance suffered in the early part of 2010. Concerns over inflation and growth resurfaced as monetary tightening in China along with more a mixed public sector demand picture developed. While we continue to find good opportunities in Emerging Markets, we have become more risk averse in terms of stock selection.

## OUTLOOK AND STRATEGY

| | Policy | Change | Comment |
|---|---|---|---|
| US | Overweight | ↑ | The US economy has bottomed and there are strong signs of a broadening recovery from housing, construction, to industrial output. The corporate sector looks set to benefit from a recovery in demand with earnings and profitability projected to rebound. Relative valuations vs. growth prompt us to lift our exposure to Overweight. |
| Europe | Underweight | ↓ | Leading indicators in Europe have rebounded sharply, but fiscal headwinds may constrain growth. While European valuations are amongst the cheapest in the world, there are structural concerns that may limit performance. We stay Underweight. |
| Asia (ex-Japan) | Overweight | ↓ | Growth in Asia has rebounded sharply as have earning expectations. However, China's decision to tighten momentary conditions in the face of a weaker than normal recovery, prompts us to adopt a more defensive stance, focused more on stable growth sectors. While valuations are more attractive, we have tempered our Overweight position. |
| Japan | Slight Underweight | – | Even after a decade of under-performance, Japan was not immune to the global slowdown. The Japanese market has a large concentration of export oriented and cyclical companies that should benefit from the recovery. The bad news is that corporate profitability has to recover a long way to warrant meaningful capital allocation. We are slightly Underweight. |

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| Latin America | Overweight | – | Latin America has recovered strongly due to buoyant domestic demand. There are some near term risk due to higher inflation levels. However, this should not derail the region's rebound. The region continues to offer strong long term investment opportunity for equity investors. We retain our Overweight position. |

3Q GDP data has confirmed that the global economy has exited recession. More recent labour market data provided strong evidence that the recovery is entrenched and that growth will continue to gather momentum into 2010. The need for de-leveraging in the Developed world and the need to rein in fiscal deficits pose a risk to growth if not managed carefully. We believe that policy makers will maintain an accommodative monetary stance through the better part of 2010 to mitigate the risk attendant on fiscal constraint.

In order to stave off depression, governments undertook unconventional actions and have rapidly accumulated debt. A clear but gradual exit strategy is essential in order to avoid a potential shock to confidence as governments step back from guaranteeing deposits and debt, divest from investment holdings, lift policy rates, balance budgets and implement structural changes to avoid any potential threats to confidence into the recovery.

The industrial word benefitted in 2009 from a rundown of low cost inventories and efforts to rein in operating costs. And while production and sales are slated to rebound in 2010, the key challenge and question is where margins will come in. Aligning supply and demand curves may prove a challenge.

We continue to have a significant asset allocation in Emerging Markets. With monetary policy likely to remain accommodative, we believe that the prospect for growth to surprise on the up-side is greater in the Developing world, and in particular in economies with latent but expanding domestic demand as is evident in places like Brazil and India.

Our **US** exposure stays as an Underweight. The recovery in the broader economy is gaining traction, but the medium term growth trajectory is likely to remain modest given debt constraints on all levels. While the market does have a large share of globally diversified industry leading companies that will benefit from global growth, there are more direct beneficiaries in some Emerging Markets.

We also keep **Europe** at an Underweight. While, *ceteris paribus*, the Eurozone appears to be the cheapest region, structural challenges and financial risks prevent us from being more aggressive. The region faces headwinds of a significantly changing financial sector landscape, a strong currency, and less flexible labor markets, which may limit earnings gains into the recovery.

We retain **Japan** as Underweight. The Japanese market is expected to remain a laggard against a backdrop of moderate cyclical recovery. The corporate sector, with its export orientation, is a leveraged play on the global recovery. But it is a bit like an out-of-the-money option, requiring substantial growth before that leverage kicks in. The policies of the new Democratic Party of Japan (DPJ) government may have negative implications on domestic growth.

We remain Overweight **Latin America**. We continue to view the region as offering the best risk adjusted prospects of any major region. The region remains underpinned by strong domestic demand and yields an abundance of good investment opportunities. We continue to overweight sectors that should benefit from a structural increase in domestic demand.

We also keep **Asia-ex-Japan** at an Overweight. Opportunities in Asia will be aided by the global recovery, with earnings expected to continue to enjoy upgrades. Stock selection is likely to be more critical as valuations offer less upside than before after a strong re-rating. As many of the economies around the region step back from prior stimulus initiatives targeted at boosting domestic demand, we are increasingly looking for opportunities among the export sectors that should benefit from global recovery, and where valuations are more reasonable.

We retain **Canada** and **Australia** as Neutral exposures. Both regions have performed well through the downturn. Given the composition of their markets, which is heavily skewed to the resources and financial services sectors, we view these markets as more late cycle and more deep cyclical. Hence, against the expectation of a moderate economic recovery we are at best Neutral.

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