Market Commentary

August 2010

GLOBAL EQUITY

EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	5.1	-6.5	-6.3	2.9
MSCI World	5.1	-6.9	-6.8	1.8
MSCI USA	4.0	-8.1	-4.5	5.4
MSCI Europe	8.6	-4.6	-11.9	-1.9
MSCI Japan	1.1	-7.3	-3.9	-7.3
MSCI AC Asia ex-Japan	2.6	-3.2	-2.9	5.7
MSCI Emerging Markets	5.1	-3.6	-3.0	11.0

Returns in Singapore dollars. Source: Bloomberg, 31 July 2010

World equity markets rebounded sharply in July, with the MSCI AC World Index up by 8% in US dollar terms. Following the establishment of a financing guarantee scheme by the Eurozone member governments, the Euro strengthened by over 6.5% vs. the dollar. European equities led the surge, up by 11.5% in the month (half coming from the currency). Exporting regions (Japan & Asia) lagged due to concern over a weaker US dollar.

Economic indicators, while still positive, are more mixed. US indicators continue to point to weakness on the employment front, and forward indicators have peaked out. By contrast leading indicators in the Eurozone continue to point to strength. Some of the strength in indicators was linked to the weaker Euro, so the more recent Euro strength will need to be monitored. Meanwhile production data out of Japan has softened slightly, reflecting a softening of external demand.

Also of note is the fact that monetary policy remains highly accommodative, with policy rates across the developed world very loose. With inflation not a significant risk, accommodative monetary policy should continue to help to mitigate some of the risks associated with fiscal consolidation.

We will continue to monitor the fiscal adjustment process in Europe and the US. Given the tepid recovery, we remain concerned that overly zealous fiscal consolidation could destabilize the recovery. So far there is limited evidence of this, although we'd note recent weakness in jobs data in the US. Private sector jobs additions have not been sufficient to off-set reductions by the public sector – we will continue to monitor.

Markets have recovered sharply following the passage of a rescue package in the Eurozone. The removal of this uncertainty, coupled with generally favorable corporate earnings announcements have helped to fuel the market recovery.

OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Overweight	–	The US economy has bottomed and there are signs that the industrial recovery is broadening out. While the housing market appears to have stabilised, the job market remains soft. Having moved aggressively to manage costs during the downturn, the US corporate sector is poised to benefit from the gradual recovery in final demand. The US appears to be the first-in/first-out (FIFO) of the Developed Markets. Relative valuations vs. growth prompt us to stay Overweight.
Europe	Underweight	–	Leading indicators in Europe have rebounded sharply. And consensus growth estimates are being raised. The bank stress test did not reveal much, and while we remain skeptical, the results did help to restore market confidence. Despite the fact that European valuations are amongst the cheapest in the world, structural concerns prompt us to stay Underweight.
Asia (ex-Japan)	Overweight	–	Growth in Asia is moderating, but remains strong. China's tightening bias continues to pose longer term risks, as strong upward wage adjustments add to cost pressures. We remain more defensive, focused on sectors where pricing power should be stronger. We have a bias toward domestic demand driven businesses over exporters.
Japan	Underweight	–	While Japanese corporate profits are projected to rebound sharply in the current year and next, core operating performance leaves much to be desired. Recent Yen strength has weighed on exporters. Corporate profitability still needs to recover further before we can justify further capital allocation. We are slightly Underweight.
Latin America	Overweight	–	Latin America remains our preferred region, underpinned by strong domestic growth. While there are some near term risks due to higher inflation, central banks are generally ahead of the curve in fighting inflation, most notably in Brazil. The region continues to offer strong long term investment opportunities for equity investors. We remain Overweight.

In the Developed world, extended debt levels are a significant headwind. Household and public sector deleveraging will be a headwind to growth. While we had been hopeful that business investment picks up, we do not believe that net export growth would be able to fully mitigate domestic de-leveraging headwinds. Our investment strategy, with a bias towards companies that are positioned to sell into higher growth emerging economies, reflects this view.

Industrial activity in the developed world has still not recovered to pre-crisis levels. This raises questions over expectations of a strong recovery in corporate investment. Furthermore, the UK and the Eurozone pose continued risks, especially in the face of market imposed and politically mandated budget reductions. And while expectations are for a cyclical bounce in corporate spending, we anticipate a downward bias to expectations.

The Emerging world continues to grow at a significantly faster pace than the developed. However, the rate of growth is moderating sharply. Recent data from China points to a slowing in industrial activity, with growth in car sales falling to 10.9% in June from 25% in May. Meanwhile cost pressures remain acute, as labor unrest and strikes have put significant upward pressure on wages. We continue to focus our investment strategies on domestically driven growth opportunities within Emerging Markets. To gain leverage to the domestic demand growth of emerging markets we've turned to the most under-levered economies. Latin America, Africa, Eastern Europe, India and Indonesia are good examples.

Given the evolving shape of the recovery and the heightened sensitivity to risk, equities have been volatile. We will need to monitor the impact of fiscal consolidation. However, with profits recovering, and valuations sill attractive, equities remain our asset class of choice. While valuations suggest meaningful upside, earnings revisions are looking less clear. Stalling final demand and higher input prices are likely to be the key determinant of near term profit trends.

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