



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	-3.4	-12.8	-10.9	5.7
MSCI World	-3.8	-13.4	-11.4	4.2
MSCI USA	-6.0	-12.1	-8.1	8.1
MSCI Europe	-1.1	-16.5	-18.8	-0.9
MSCI Japan	-2.2	-10.3	-4.9	-4.6
MSCI AC Asia ex-Japan	1.3	-5.8	-5.3	15.4
MSCI Emerging Markets	-1.1	-9.2	-7.7	16.3

Returns in Singapore dollars. Source: Bloomberg, 30 June 2010

World equity markets continued to drop in June, with the MSCI AC World Index down a further 3% in US dollar terms. US markets led the decline, off by more than 5 percent in the month. Meanwhile, European markets are down by 18% year to date, as concerns over public policy weigh on their currencies. The best performing regions of Asia and Japan, are also in negative territory for the year.

Concerns about public debt levels have continued to add to market volatility. Meanwhile, economic indicators, while still positive, are turning slightly downwards, Observers point to concerns over the strength of the recovery. While economic activity has suggested a broadening recovery, employment trends remain weak, and some forward indicators appear to have peaked out.

Last month we wrote extensively about the risk of overly abrupt fiscal consolidation and how this could destabilize the recovery. We suggested that this could result in a **VS** shaped recovery, with the S being the slippery slope of policy mistakes. In May, Merkel's center right alliance in Germany announced €80bn of targeted budget reduction. Meanwhile in late June, UK Chancellor, Osborne in his first budget announced a plan to reduce the deficit from 11.1% of GDP in 2011 to 1.1% of GDP by 2015. In all, spending cuts of £32bn were target over the budget period.



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Markets have started to stabilise following the passage of a rescue package in the Eurozone designed to cover the refinancing needs of the more extended economies. Nonetheless investors remain concerned over the broader growth outlook as governments face increased pressure to reign in deficits. Adding to concern is the ongoing tightening in China. A backdrop of more rapid fiscal adjustments could represent a strong headwind to the cyclical recovery. This is of particular concern in the UK and the Eurozone.

While we have been concerned about the fiscal drag ahead, we are now more concerned about a premature or abrupt withdrawal of fiscal stimulus. The good news is that economic indicators in the US and Europe remain in positive territory, corporate profits remain strong, inflation is not a significant risk, and valuations are reasonable.

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. However financial conditions have deteriorated and fiscal headwinds may constrain growth. Consensus estimates for Eurozone growth continue to be reduced. Bank stress test results are expected to reveal the need for significant capital. 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 continues to be strong. However, China's decision to tighten monetary conditions to address an overheating property market, have raised concerns. Strong upward wage adjustments prompt questions about corporate earnings and add to inflation concerns. This prompts us to adopt a more defensive stance, focused on domestic consumption.
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.
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In the Developed world, extended debt levels are becoming a significant headwind. We had been hopeful that business investment would pick up and off-set the slack of a consolidating public sector. However, data suggests that there are increasing risks to this view. While industrial activity has recovered from the distressed levels of a year ago, they are still well below peak. Excess capacity still hasn't been fully absorbed, prompting observers to reduce 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. This uncertainty is putting downward pressure on corporate spending.

While the Emerging world continues to grow at a faster pace than the developed, it is starting to slow. 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 started to feature prominently, with at least eight strikes hitting automobile and component supply companies since May. We continue to focus our investment strategies on domestically driven growth opportunities within Emerging Markets. This leads us to markets like India and Indonesia, as well as to regions like Latin America, Eastern Europe, and Africa, where investment and debt levels are not a constraint.

Equities remain attractive as an asset class, with recovering profits and cheap valuation likely to remain a tail-wind. Supportive of the market are low interest rates, with expectations of future policy tightening being pushed out well into 2011 and beyond. While equity valuations suggest meaningful upside, earnings risks have shifted slightly to the downside. Staling final demand and higher input prices are likely to be the key determinant of near term profit trends. Meanwhile, the fiscal consolidation process poses an ongoing challenge.



Market Commentary

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