

QUARTERLY INVESTMENT STRATEGY

FIRST
QUARTER

2012

INVESTMENT OUTLOOK AND ASSET ALLOCATION

*Cautious investment stance –
Neutral equities and fixed income,
underweight commodities*

GLOBAL EQUITY STRATEGY

*Stalled growth in the US, growing
troubles in Europe and slowdown
in Asia call for a cautious stance
in equities*

GLOBAL FIXED INCOME STRATEGY

*Defensive positioning with
overweight in investment grade
credits*

CURRENCIES

*Cautious on Asian FX, possible rally
in the under-valued greenback*



SAILING
through Choppy Waters



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CIO MESSAGE

Although it has been only a quarter since our last strategy review, the investment climate appears to have changed drastically since then. The Europe debt contagion has widened to hit Italy, while German government bonds look increasingly vulnerable to the loss of confidence spreading across the continent.

While the US economic data stabilised over the past quarter, there remains debate over whether US will muddle through next year, especially with the potential fiscal drag and slowdown in industrial activity looming in the horizon. Sitting in Asia, we are aware that the fast-growing region is not immune to such shocks either, and this is already clear from some of the weak export numbers seen across many economies.

Whilst in the last quarter we were equally concerned about trends in the US and Europe, this quarter we are primarily focused on the risks emanating from Europe. The US, ironically, has become somewhat of a standout with better economic trends than Europe or even the Emerging Markets. The US may have demonstrated this summer that its economy is not as fragile as most economists had been assuming. Nevertheless, with European risks escalating, the US and Emerging Markets both remain at risk.

What is clear, however, is that the last quarter had been a choppy and volatile period for both bulls and bears alike, and this is set to continue in the year ahead. But even without perfect clarity on how the first quarter will go, we believe that there are still hidden gems in the market waiting to be discovered.

This is true not just for emerging market equities, but also high quality corporate credit instruments. Some of these instruments have proved to be great risk diversifiers, and the advantage of investing in times like these is that valuations are attractive.

Several quality counters have seen their price nose-dive, despite their strong fundamentals. And it is during times like these that investors can pick up strong counters at bargain prices. When calm eventually returns to the market, we are confident that investors with sharp investment acumen will be rewarded with the strong price ratings in the market.

In the case of Asian markets, we are still fundamentally positive about its longer-term outlook. However, we feel that the increasingly averse global environment will likely not favor Asian equities, and therefore a cautious stance in equities is warranted.

Three months ago, we recommended exposure to gold, and that's one call that has not changed over the period. For one, gold equities have still not caught up with spot gold price gains, while the yellow metal is technically well supported by the buying in the spot market. In periods of extreme stress, it tends to do well. For this reason, we advocate that investors consider some exposure to gold and gold equities to diversify their risks and perhaps regain the shine in their wealth.





SUMMARY

Over the past quarter, the global picture grew cloudier. While economic activity in US beat expectations with a decent bounce, the conditions in Europe worsened significantly, as Italy became the latest country to fall to the contagion of the debt crisis. As the country is a G7 country and major Euro zone member (third largest by GDP), troubles in the Adriatic definitely bodes ill for the entire continent. In its current form, the European Financial Stability Facility is clearly unable to tackle all the European debt problems if Italy eventually requests for funding. As a result, the situation in Europe is rapidly deteriorating, while confidence in even the core members took a retreat. Taken together, these developments point to a challenging quarter ahead for investors worldwide.

However, China is showing signs of easing. Admittedly, China's real estate problems remain challenging, as it is not clear where property values will settle after the sharp rises of the past two years. This is important since a hard landing in the property market could lead to losses piling up at the banks, and affect credit markets there. However, we should also recognize that Beijing has the ability to ease up liquidity and has already started doing so with its 50 basis point cut in the reserve requirement ratio. We believe that authorities may possibly ease up further on liquidity, in which case, there could be some relief to markets that have underperformed since the tightening started despite strong GDP growth and corporate profits.

Growth outlook moderated for Emerging Asia. Although Asia generally enjoys stronger economic fundamentals relative to their developed counterparts, the region is not immune to troubles in the Western world. The deterioration in the developed world suggests that external demand and growth prospects in Asia will likely moderate, and result in stronger headwinds for Asia's growth over the next six to 12 months. Already, China's trade numbers have shown clear signs of weakness, while electronics shipment from Singapore slumped over the past two weeks. The poor export figures show that Asian economies will likely slow further if global environment worsens. The Global Financial Crisis in 2008 demonstrated that the impact on Emerging Markets economies from problems in developed markets can be significant. Nevertheless, Emerging Market also demonstrated the ability to rebound rapidly to trend growth after the crisis abated, and thereby offer both risks and opportunities.

In this environment, we recommend a cautious investment stance by going overweight in high quality fixed income assets and gold. We also recommend a neutral stance on equities. Within fixed income, we continue to prefer Investment Grade bonds, while retaining our underweight in high yields and European sovereign paper. Within equities, we are overweight in US and neutral on Asia, but remain cautious on European stocks. Within commodities, gold is our top call with a price target of US\$2,300 per troy ounce.

INVESTMENT OUTLOOK AND ASSET ALLOCATION

Talk of “2008” grew more strident in the fourth quarter, as the investment community assessed the risk of a Euro zone break-up and whether it would trigger a “Lehman-like” meltdown in the banking system like what we saw in 2008.

Such concerns are understandable, given the way credit market can again seize up in the worst case scenario. In addition, with the weaker state that the United States economy is in now, equity markets can hardly afford to endure a repeat of September 2008.

While we think that Europe can avoid a full blown banking crisis, we see that policy leaders are struggling with certain risks. They are trying to balance taking the steps needed to reduce the panic in the sovereign credits versus maintaining pressure on the various peripheral countries to take the reforms needed to address the long term problems. Peripheral sovereign bond yields have been rising rapidly and are a clear sign that the “contagion” is spreading and the panic is getting worse. We fear if not addressed soon, the panic can rise to levels that will affect the banking system and thereby risk a new “Lehman-like event”.

Globally, we take comfort in the fact that recent US data have been turning around nicely, and there is a good chance that the US will avoid recession. The consensus right now is a low growth scenario of about 2%, and we find hard to differ from consensus. Some of the recent bounce shows that markets were clearly too bearish previously, and the situation is not as dire as some have pronounced.

Investment markets are balancing the positive news that the risks of a US recession has eased considerably over the past quarter and valuations remain near historic lows, while at the same time a major risk-event in Europe looms. It is possible for markets to rally significantly or take sharp negative hits over the next quarter, mostly driven by what happens in Europe. We think it is too much of a guessing game trying to predict the actions of European politicians and thus recommend taking neutral stances in most asset classes and look out for signs that European conditions are improving or deteriorating.

1. Europe bears close watch

The crisis in the Euro zone has clearly spread, now counting Italy – the third largest economy in union, as its latest victim. Over the quarter, Italy saw its 10-year bond yields shoot up beyond seven per cent, and throwing the country into political and financial disarray.

Berlusconi has since stepped down after much political wrangling, but the markets are still not convinced that Italy can get its house in order as it should. If growth stays anaemic at say two per cent, while bond yields remain sticky at seven per cent, the country will struggle to meet its debt obligations.

And this has implications not just for Italy but also the Euro zone. At current interest rates, it is a mere matter of time before Italy will have to seek aid from either the European Financial Stability Facility (“EFSF”) or International Monetary Fund (“IMF”) or both. Either of these options will spell a tough road ahead.

The IMF will disburse funds only on conditions that the aid countries accept its terms for economic restructuring. In a nutshell, it means textbook style austerity and tightening to raise competitiveness and fiscal discipline. In the long run, this is beneficial for the country, but the process is certainly a painful one as what we saw during the 1997 Asian Financial Crisis. Also, the Italians may not have the political will to push through the reforms required under any IMF aid package.

Seeking help from the EFSF means more austerity as well, but it means that the other union members will clearly have to get their act together in leveraging up the EFSF fund size. The European Union (“EU”) has the financial firepower to handle the outstanding debt of the Greek government, which comes up to about 400 billion euros. The EU could also come to the rescue of Portugal and Ireland again if needed. However, Italy is a great challenge, because the outstanding debt of the Italian government totals about two trillion euros. Given the sheer size of the outstanding government debt, the country is too big to “bail out.”

Between now and April 2012, the government needs to make more than 200 billion euros worth of principal and interest payments on its outstanding debt. If the government is unable to roll the maturing securities at less onerous rates, it will need to restructure its debt.

In that event, financial institutions in Europe would have to write down hundreds of billions of euros worth of Italian debt. Given the linkages within the global financial system, strains in Europe would be transmitted to the United States through risk premium in lending rates. Already, three-month dollar London Interbank Offered Rate (“LIBOR”) has risen 20 basis points since early August, when the crisis started to intensify again. LIBOR could push higher if Italy were to default.

The uncertainty is not only weighing down on the markets, but has visibly affected core economic activity. Latest data show that the Euro zone is possibly on the brink of recession. The purchasing managers’ indices (“PMI”) for both the manufacturing and service sectors slipped further into contraction territory in October. Even Mario Draghi, the new president of the European Central Bank (“ECB”), acknowledged that the economy likely would experience a mild recession in the quarters ahead.

Already, factory production in Germany fell 3.1 per cent between its peak in July and September, while the 4.3 per cent drop in factory orders in September bode ill for German industrial production in the last quarter of the year. Notably, domestic orders for capital goods fell nearly seven per cent between July and September. The evident pullback in German capital spending may be due, at least in part, to uncertainties related to the European sovereign debt crisis.

The sovereign debt crisis, which has been festering for nearly two years, has entered a dangerous phase as Italy reached “the tipping point.” The core European leaders will certainly have to show leadership if the community is to emerge from this crisis intact. Anything short of that will see the contagion widen and result in a break-up of the union.

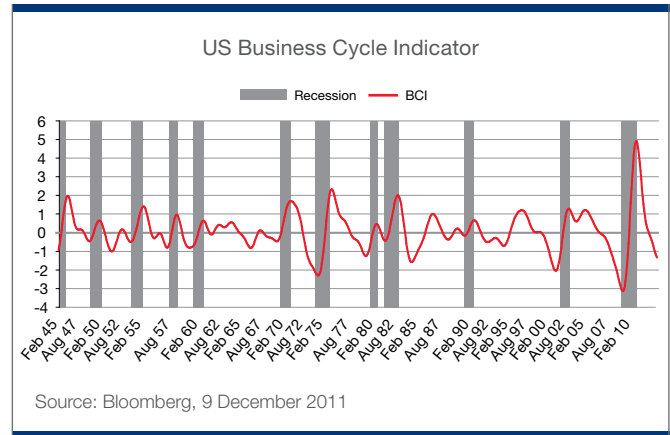
2. Fear of US recession recedes

In the case of the US, even though growth is still slowing, most of the leading indicators and jobs data have come in better than expected. We believe that while the US is structurally weak, and that there could be negative loop from the Europe crisis, the risk of a fresh recession is receding.

The National Federation of Independent Business (“NFIB”) survey for October signaled that small business optimism did improve over the past month, however, overall levels of optimism remain very depressed. Job gains within the small business sector have been difficult to come by lately, a trend not likely to end soon. The number of small businesses reporting plans to hire declined in October to just three percent of respondents. Plans to increase spending on capital equipment, such as computers and software, remained weak again in October with only 21 percent of respondents indicating they would increase their spending. Another clear trend from the survey was that the pessimism among small business owners remained high that the economy will take time to get better, suggesting that the small business sector is not likely to contribute to growth anytime soon.

Initial jobless claims continued their gradual decline last week with 390,000 first-time claims filed in the first week in November, the lowest level for jobless claims in seven months. The four-week moving average, a reflection of the overall trend in jobless claims, fell to the important 400,000 mark that typically signals stronger job growth.

Following the 80,000 rise in nonfarm payrolls in October, the somewhat-faster decline in claims in the first week of November suggested that job growth may pick up slightly in November. However, the overall job growth environment will continue to be weak as the slow pace of economic growth continues to hold back job gains over the next few quarters. The global economic uncertainty coupled with domestic policy and economic uncertainty will remain a headwind to growth over the next year.



Additionally, the Institute of Supply Management (“ISM”) new orders minus inventories showed improvement, even though there could be some cyclical weakness in the second quarter of next year. Still, considerable risks are in place. The industrial production cycle is already slowing while manufacturing profit margins have started to level off.

3. China’s property market correction

While China has maintained the most consistent and strong growth in the world over the past decade, global investors remain concerned over issues including the risks of declines in property values, weakening exports to Europe and loan defaults from loans made to local governments. Many investors have seen overhangs in various developed markets after property declines, and after the rapid rise in property values over the past several years it now appears to be a risk in China. Property construction has been a big contributor to overall GDP growth and a decline in property sales could jeopardise some of the economic growth pillars. Offsetting some of the worries, is that, unlike the property bubbles that have triggered recession in developed markets, China’s property bubble has not been built with leverage. This mitigates some of the downside risks, especially when compared to other markets.

To some extent, the weaker property prices that are being seen in some China cities are a result of the authorities tightening the credit in China. Already, the excess liquidity in the country has fallen sharply and while Beijing is easing

policy slightly, the property market may not see a bounce anytime soon.



This has implications for the banks that extended credit to property developers in the good years. If prices stabilise at current levels, the spillover effect onto the banks' balance sheets may still be manageable. However, if prices continue their steep declines as what we saw earlier, the losses at the banks may just pile up sharply. The construction business may also undergo a period of slow activity, as businessmen expect lower prices and therefore scale back on their projects. Overall, the drag on the investment demand for China is likely to be significant in a worse case scenario.

Beyond that, we also note that the external environment has grown more hostile to China's exports growth. Already, both imports and exports have declined by over 20 per cent in recent months, and since the start of the year, China has run a trade deficit instead of a surplus. Combined with the domestic credit controls, growth in China is expected to moderate further from the levels we saw in 2009 to 2010.

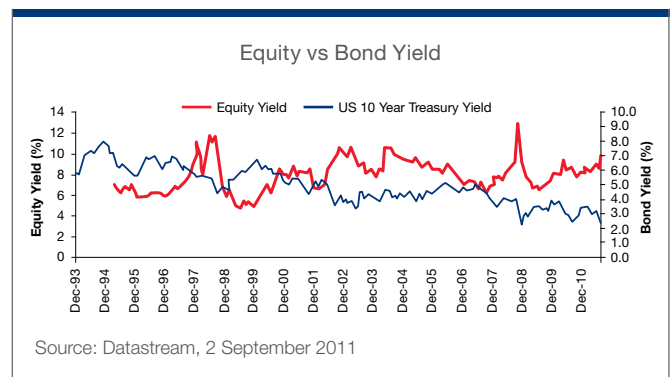
However, the silver lining is that inflation is coming off the boil, and if the trend continues, we may see headline inflation falling to 4.2% in November after hitting 6.4% in the middle of the year. The authorities are also committed to carrying out structural reforms and promoting the small and medium-sized businesses. A thriving small and medium-sized

business community helps cushion the shock from external macro headwind, and the government's ongoing attempts to switch to a consumption-led model will also help its economic prospects in the years to come.

Overall, we are tactically cautious owing to the sharp correction in property market, and the spillover effects that this may have on the banking sector. In a recent report, the IMF also flagged out this issue, pointing out that rampant lending since 2008 has left many companies and local governments in China with huge debts, while a recent slowdown in economic growth and falling property prices have fuelled fears of an explosion in defaults.

4. Valuations stay attractive

Despite the negative headlines, we note that equity valuations are still attractive, even for the high quality counters. In Asia, where economic fundamentals are far stronger than that in the West, prices have come off a fair bit, as seen from the widening equity-bond yield gap. We note that this is partly a result of depressed ten year treasury rates, while Asian markets got hammered by a risk-off mode across the world. However, long-term investors can seize the opportunity to buy into compelling counters or markets at this stage, without having to pay a high premium for it. In the longer term, economies and markets will eventually recover, and we believe that good quality counters will then receive their stamps of approval by then.



In the medium term, however, we acknowledge that growth expectations have been reduced for next year, the trend for earnings is clearly on the downside. The market has rounded to that view, and equities may not re-rate unless there's a major turn in economic data. Indeed, a pullback in both domestic and global demand will likely squeeze corporate margins, and profits over the next few quarters should begin to moderate, in line with the global economic slowdown.

5. Assessment

In summary, the external backdrop has improved in the US but has clearly worsened in Europe from the previous quarter. The European crisis has now seen the contagion of panic spread to Italy as its bond yields have jumped, and the loss of confidence is now also affecting Germany's ability to raise funds in the debt markets. As the Europeans struggle to get their act together, there's growing talk of a potential breakdown in the European Union.

While that's still unlikely at this stage, it is clear that such an event can potentially cripple the credit and equity markets again, as losses pile up in the financial industry. Therefore, the overhang on the equity markets over the short term is likely to persist, and prices are unlikely to recover in the short term.

In the US, the data has turned around nicely, while the government's estimate of two per cent growth in the third quarter affirmed the improved fundamentals there. That said, the US is hardly achieving rapid growth and a significant shock from Europe could easily push it into recession. For these reasons, we remain cautious on the outlook in the developed world.

Elsewhere, China's slowdown in property and its weaker exports to Europe stand out as another risk. There are some indications that the authorities will continue to tighten lending related to the property sector, in a bid to snuff out the speculation in the market. Fortunately, the authorities are also likely to ring-fence the banks to prevent massive systemic fallout.

Elsewhere in the emerging markets, the growth outlook has weakened. Already, we have seen countries such as China and other Asean economies report slower PMI readings, while factory output growth has largely moderated over the past few months. These trends are broadly consistent with the recent deterioration in the G10 outlook. And the weakening growth profiles for Europe clearly point to more headwinds to orders and production.

Against this backdrop, we recommend going neutral on risk assets. While we recognise the improved fundamentals in the US, the problems in Europe are simply too serious to ignore, and there is the threat of a negative feedback loop into the US. Asia is not immune too. Already, we have seen markets here sold off on bad news from the continent, and this pattern is set to continue in the next few months.

Within commodities, we still prefer gold as it benefits from extreme stress in the financial system. Technically, the price is well supported, and we think that gold can move higher in the next one year. Interestingly, gold equities have not moved up as much as spot gold price, and there's the potential for upside surprises in gold counters. In addition, we also like silver, platinum and copper. Silver and platinum now look cheap relative to gold, and copper may well be supported if there will be further monetary stimulus in the US.

We have a neutral position on fixed income, even though US treasuries already look fairly rich. The truth is that rates are now at multi-year lows, which means the upside is limited. However, we acknowledge its safe haven status during uncertain periods, and will not rule out its performance on risk aversion trades. As in the case with equities, there are some high quality corporate credits that look attractive at current yields, and therefore, may perform well when calm returns to the market.

ASSET ALLOCATION

	Conservative	Change from 4Q 2011	Moderate	Change from 4Q 2011	Growth	Change from 3Q 2011
Equities <i>Neutral</i>	46%	11%	55%	3%	60%	5%
Bonds <i>Neutral</i>	40%	-10%	38%	-2%	30%	10%
Commodities <i>Underweight</i>	4%	-1%	4%	-1%	5%	-15%
Cash instruments <i>Overweight</i>	10%	0%	3%	0%	5%	0%

Note: The neutral Moderate benchmark weights are Equities (55%), Bonds (38%), Commodities (7%) and Cash (2%).

We are cautious in our asset allocation, with adjustments to our commodities, equities and fixed income recommendations.

Equities – Upgrade to Neutral

The weakening in leading indicators is a key factor in adopting a cautious stance. Any significant slowdown in the US means that China and others may follow suit. Additionally, the spectre of Greek debt woes weighing down on sentiments means that equities may not have significant upside from current levels.

Fixed Income – Downgrade to Neutral

The growing macro headwinds and accommodative monetary stance means that safe haven fixed income instruments may have further upside in the coming months. However, as interest rates are already at low levels, any lowering of rates seems unlikely at this stage. Therefore, we stay neutral at this stage.

Commodities – Underweight

We are neutral in commodities, even though we are relatively more bullish on gold. The positive call on yellow metal is due to our cautious view that the US economy is poised for a slowdown and therefore, a safe haven asset like gold will benefit from a risk off mode.

Neutral position in Equities

The rapidly worsening environment in Europe clearly has a visible drag on the economy, and its trading partners. Already, we saw significantly weaker export numbers across a number of Asian countries, particularly in the electronics segment, and this is evidence that a weak Europe is bad for the rest of the world.

On top of that, US remains structurally weak even though the recent bounce in economic data and short term leading indicators suggest that the situation is not as dire as initially thought. However, we will still urge caution at this stage, as there is the threat of negative feedback loop from Europe to US.

That said, there's a chance that the US Federal Reserve will launch a third round of quantitative easing and this will drive equity markets up again. As the odds are not entirely clear, we maintain a neutral stance on equities.

In **Europe**, the adverse developments continue to hog the headlines. Over the quarter, Italy joined the ranks of troubled members, as concerns grew about its ability to service its debts. Accordingly, its ten-year borrowing cost pushed higher at above seven per cent and dented confidence that Euro zone is able to address its growing debt problems if Italy has to ask for aid. The contagion has spread to Germany, as the European strong house reported a weak bond auction. We believe that the macro headwinds from Europe are simply too significant and will be a major overhang in the medium term.

In the **US**, growth is still slowing even though most of the leading indicators and jobs data have come in better than expected. While the US is structurally weak, we believe that the risk of a fresh recession is receding, and therefore, will stay slightly overweight on US.

For **Japan**, leading indicators suggest weakening near-term outlook due to the deepening Euro debt crisis and strong Yen. Earnings visibility is also getting more clouded. However, we note that the third supplementary budget has been passed, and reconstruction is expected to underpin demand in the first half of the financial year of 2012. Meanwhile, valuations are supportive. Credible solution to Euro crisis is needed for any sustainable market rebound.

We are now overweight on **Asia ex Japan**. The risk-return profile for the region is far more attractive than stocks in developed world, and we still think that Asian equities are still attractively priced with healthy growth prospects.

We continue to like **Latin America** for its strong domestic growth. The long term structural story intact underpinned by domestic demand and underleveraged population. The region continues to offer strong long-term investment opportunities for equity investors. We remain overweight in Latin America.

Neutral position in Bonds

Governments Bonds should benefit from the accommodative monetary stance in place across several countries, as the global macro backdrop becomes increasingly hostile. Indeed, the ECB may cut rates further, while US Federal Reserve may still launch a third round of quantitative easing if the conditions in the United States worsen. However, we note that the risk of US recession has receded. Additionally, the threat of growing turmoil in the capital markets means that flight to capital should be expected. This will benefit US Treasuries and other safe havens. However, as the rates are already at historic lows, it is not clear if there will be significant upside for government bonds

In emerging markets, central banks have started to ease monetary policies as the economic growth starts to decelerate. In the near term, emerging market fixed income markets would be under pressure but remain structurally positive over medium term. Overall, we maintain an overweight in emerging markets, with a preference for Commonwealth of Independent States, Middle East, Asia and Latin America. We are underweight in Africa and Eastern Europe.

Corporate Bonds continue to enjoy attractive value, especially for the investment grade corporate credits. We are overweight in this segment on the back of positive corporate fundamentals across a number of sectors. High yield paper is not preferred as it does not thrive in a slow growth environment, like now. We are neutral on duration.

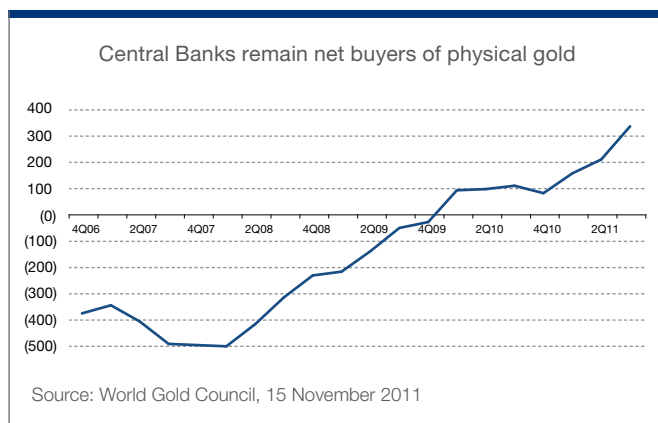
Asset Allocation	1Q 2012 Recommendation	Benchmark
Fixed Income	40%	38%
Developed	30%	70%
Government	45%	71%
High Grade	50%	21%
High Yield	5%	8%
Emerging	70%	30%
Asia	29%	30%
Latin America	32%	33%
CIS/EE	27%	27%
Middle East/Africa	12%	10%

CIS – Commonwealth of Independent States
 EE – Eastern Europe

Underweight position in Commodities

We are underweighting commodities given the persistent financial problems in Euro zone economies, softness in Chinese commodity demand and mixed data from the leading OECD economies. The impact of Europe's financial problems has raised doubts about near-term global demand and has resulted in downward price trends for most commodities. While the equity valuations of commodity companies appear inexpensive, we note most analysts' spot price forecasts are still well above current spot levels. Looking forward, the most bullish pricing scenarios assume future monetary easing rather than robust demand projections. Therefore, we remain cautious until a durable solution to Euro zone funding issues is in place, most likely supported by additional stimulus action from the US Federal Reserve.

We maintain our overweight position in Gold. Our bullish view for the physical gold price is based on strong central banks' demand, continued negative real interest rates, the prospect of further monetary stimulus, and buoyant institutional & retail investment demand. Data from World Gold Council shows that central banks bought over 300 tonnes of gold in the 12 months ended September 2011.



Within the **Energy space**, we move to an overweight position in Crude Oil and a neutral position in Natural Gas. Brent crude oil price remains at elevated levels, with geopolitical problems in Libya now replaced by growing tension in Syria. Developing markets' demand continues to be strong, and US data now indicates a lower level of inventory – a reflection of strong buying. While US natural gas prices remain depressed, certain shale gas producers can offset this weakness with strong volume growth.

We have a largely neutral position in **Bulk Commodities** and predominantly underweight position in **Base Metals**. Seaborne thermal coal demand is typically strongest in the Northern Hemisphere's winter months, and so investors can expect rising near-term demand from China and India. However, the subdued outlook for Chinese steel production is exerting downward pressure on iron ore and coking coal prices. The outlook for base metals remains mixed, with price support coming from higher production costs rather than stronger demand. We continue to prefer copper, with the ongoing strike at the Grasberg mine in Indonesia adding to existing production problems in Latin America. Grasberg produces approximately four per cent of global new copper production.

We remain neutral on **Agriculture**. The absence of weather-related shocks has resulted in lower prices across the agricultural complex, and current 2012 harvest projections are robust given increased planting area and higher projected crop yields. Although global demand will continue to increase, any future price spikes will require poor weather in one or more of the main export producing countries.

Asset Allocation	1Q 2012 Recommendation	Benchmark
Commodities	4%	5%
Gold	50%	25%
Base Metals	10%	20%
Agriculture	20%	20%
Energy	20%	35%

GLOBAL EQUITY STRATEGY

GLOBAL EQUITY STRATEGY

US

Equity Strategy

The fourth quarter saw extreme volatility in the global equity markets. For example, the Dow Jones Industrial Average traded within a 1900-point range, but the most recent downswing in late November was a result of several factors. Firstly, the US fiscal situation got off to a bad start with the bipartisan super-committee's failure to reach an agreement on the US\$1.2 trillion in federal budget savings. In China, growth momentum slowed across all segments - fixed asset investments, consumer spending as well as exports. Indeed, the manufacturing PMI as surveyed by HSBC for China, a good proxy to the Small & Medium Enterprise ("SME") business outlook, dipped to 48 in November - its lowest reading since March 2009. China data is watched closely as growth prospects of many US multinationals are highly dependent on the outlook in China.

Last but not least, the situation in Europe continued to deteriorate, and the European capital market liquidity shrank for most of November. There were concerns that a "run" on Italian debt and a European financial contagion would eventually also spill over into the US markets. The European bond markets saw relief only when the EU leaders (including the newly appointed Italian prime minister) took more concrete steps towards committing to a tighter fiscal integration in the Euro zone.

The **US earnings reporting season** this quarter yielded mediocre results, after two years of strong growth momentum. Some 60 per cent of companies beat estimates on earnings per share ("EPS") compared with an historical average closer to 70 per cent. This was five per cent ahead of expectations at the start of the quarter, which were revised down in the prior quarter, due to the slower global macro environment. Some 58 per cent of companies beat estimates on sales and 41 per cent beat estimates on both EPS & sales. Just like in the more recent quarters, the breadth and quality of the beats were not impressive. Financials accounted for much of the surprise, in part due to credit adjustments. Blended revenue growth is 11.2 per cent and earnings growth is 17.6 per cent. Excluding Energy, revenue and earnings growth would only have been 8.8 per cent and 13.1 per cent respectively.

There were growing signs of margin pressures emerging, and companies were starting to comment on the loss of visibility in final demand into the rest of the year. However, these were very much factored into the market, and the S&P 500 took the earnings result in its stride.

In terms of **near term** outlook, a continued reduction of tail risks in Europe is good for the US, as there's less of an overhang on other safe haven countries such as the US. In addition, US would be a country that could weather the European banking crisis relatively better, mainly because its banks had taken earlier active steps to recapitalise its books. While the domestic macroeconomic outlook is not robust, unemployment and housing data have stabilised, input costs are easing, and inventories remain lean both at the retail and manufacturing sectors. As a result, economic data should improve on a sequential basis.

As a case in point, when we headed into the fourth quarter of 2011, consumer and small business confidence were at two year lows, causing companies to maintain lean inventory both at the retail and manufacturing sectors. Heading into the year end, this gives room for possible positive sales surprise as seasonal demand picks up on the consumer front and businesses pull forward capital expenditures ahead of the year end.

Looking forward to 2012, however, we see growth momentum decelerating. Investors may start focusing on structural issues that will challenge the longer term outlook. We expect debate and media attention over public policy and US deficit reduction to dominate leading into the 2012 presidential election, which could in turn dent business confidence. This could keep companies from expanding aggressively and the economy from growing above trend. All these will keep the US growth at sub-par levels, at best.

Regarding **fair value** for the S&P 500, our conclusions from the last strategy report still stand. Firstly, based on historical averages, S&P Index level of 1,131 at the prior quarter ended September 2011 was pricing in a mild US recession of about two per cent contraction. Secondly, in an event of greater global slowdown, driven by a clear contagion from the European banking system into US growth, coupled by a hard landing in China, we would have expected a further 15-20 per cent decline. These two levels would provide good support for the S&P in the various worse case scenarios.

Given the current more benign near term outlook, and incorporating more recent data points, we estimate the S&P could reach a target of 1,372 based on a US\$100 EPS and a 4-5% earnings growth in 2012, and by applying a 25 per cent higher US equity risk premium relative to history. All said, given this near term momentum, coupled with longer term growth constraints, we expect 2012 to be a range bound year with the S&P 500 trading within 1,130 – 1,370.

In light of this broader caution over the structural outlook for the US, our investment strategy is to position our portfolios from a quality stand point. We focus on high quality growth companies with strong balance sheets that are more insulated from a more risk conscious operating environment. This implies that rather than compartmentalising between cyclicality versus defensiveness or growth versus value, we are looking for companies with a relatively high margin of safety from a returns angle, coupled low volatility and high sustainability in these returns. Last but not least, we favour companies with diversified and balanced growth across regions and end markets, and definitely avoid those with significant Europe/Emerging Market and/or US government/consumer exposure.

Key additions to the Model Portfolio

A recent addition to the model portfolio is **Humana Inc**, which is one of the largest managed care organizations in the US, offering health insurance to roughly 8.4 million members in the government and commercial segments. Humana has a focus on Medicare, of which it derives approximately 34 per cent of its membership base and 61 per cent of revenues. It also participates in other government programmes including TRICARE and Medicaid. On the commercial front, the company offers medical and specialty products to employer groups and individuals.

Given the failure of the Congressional Super Committee to reach a deficit-reduction deal in accordance to the Budget Control Act, the uncertainty of large Medicare and Medicaid funding cuts had been lifted. With the growing fiscal challenges that the US government is facing, ongoing efforts to better coordinate and manage healthcare services are necessary. Humana's scale and leading care management capabilities position it excellently to benefit from this growing opportunity driven by secular demographic trend; at the same time it is becoming part of the solution to deter national healthcare expenditure growth by delivering higher efficiency and realistic savings. Humana is expected to see insurance enrolment, revenue and operating earnings grow at five, seven and three per cent compound annual growth rate ("CAGR") over 2011 – 2019 respectively, and is trading at 10.6 times FY12 earnings, slight discount against peer average of 11.5 times.

Another recent addition to the Model Portfolio is **Qualcomm**. Qualcomm is the leader within the mobile communications modem space. The company has started to penetrate into the low to mid tier smart phone market through its portfolio of low-cost communications ICs. Global smart phone market is poised to grow in excess of 30 per cent to 400 million units in 2012. This phenomenon will be largely driven by the introduction of affordable smart phones and additional mobile data capacity that are being deployed in emerging countries. We expect Qualcomm to benefit from this structural trend as it will be able to increase the dollar content per smart phone as compared to traditional feature phone. Qualcomm's valuation is attractive at 15 times prospective earnings relative to a fast growing smart phone market.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Underweight	McDonalds
Consumer Staples	Overweight	Mead Johnson
Energy	Neutral	Schlumberger
Financials	Underweight	Visa
Healthcare	Neutral	Humana
Industrials	Neutral	Cummins
Information Technology	Neutral	Qualcomm
Materials	Overweight	Barrick Gold
Telecom Services	Neutral	American Tower
Utilities	Overweight	Southern Company

EUROPE

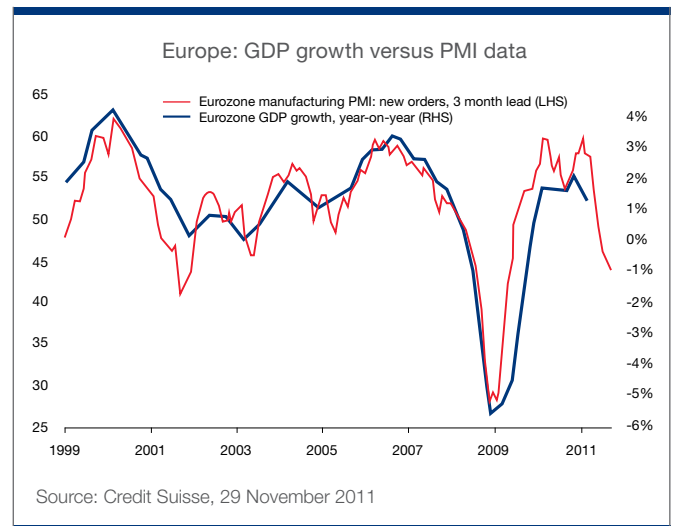
Equity Strategy

In Europe, the sovereign debt problems continued to dominate the capital markets as bond yields spiked in both Italy and Spain. There were also tentative indications that the sovereign debt risk has spread to core Europe such as France and maybe even Germany. At the same time, economic leading indicators have started rolling over, signaling that Europe is in a recession.

European politicians have been slow in implementing the solutions that have been discussed at the previous Euro group meetings. Recently, the international community has been compelling the European politicians to become more forceful in tackling the problem. After the EU Council Meeting on December 9, 2011, we heard news of closer fiscal union in Europe, except for Britain. In addition, ECB is likely to cut interest rates by around 50 basis points to 75 basis points on 8 December 2011. There is also likely to be some extension in ECB's Repo operations from the current limit of a one-year period to an extension of two to three years.

The market enjoyed a brief respite when the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve and the Swiss National Bank announced that they will reduce the pricing on the existing temporary US dollar liquidity swap arrangements by 50 basis points on the US dollar Overnight Index Swap ("OIS") rate. This helped fuel a liquidity rally. Although the market is anticipating ECB to implement an unsterilised QE, we think that is not likely to happen until the other heavily indebted countries show more progress in resolving their sovereign debt problem. But if ECB takes that route, this will help bring down the risk premium in the European market.

The economic momentum in Europe continues to weaken with consensus EPS growth this year revised down to 4.2 per cent currently from 15.6 per cent at the start of the year. 2012 consensus EPS growth is reduced slightly to 10.3 per cent from 12.4 per cent over the same period. Given the deteriorating leading indicators including the PMI Index and European OECD Composite Leading Index, there is further room for earnings disappointment ahead. Thus, the appropriate strategy remains a defensive posture. We have raised our holdings in the Defensive sectors i.e., **Consumer Staples and Healthcare**. We have also reduced our weights in the cyclical sectors including **Technology**. The Underweight position for the Financial Sector has been increased.



Key additions to the Model Portfolio

In this environment, we continually seek for companies with leadership position in growing markets and possess sustainable advantages and proven management capability. One such example is our recent addition, **Coloplast** which specialises in Continence (release of fecal & urine), Ostomy Care; Wound & Skin care products. Hence, demand is supported by chronic therapeutic demand. Moreover, it enjoys a well diversified revenue base, especially from strong economies (usually able to provide higher and more sustainable reimbursements). The company operates in an oligopolistic market with COLOB as the market leader with a 39 per cent share in the long term chronic demand for intestinal or cancer treatments. In Continence Care, it is the largest globally with a 28 per cent market share and grows by an estimated seven per cent per annum. Lastly, the company is one of the leaders in the Wound & Skin care market and is expected to grow three to five per cent per annum.

Another addition is **Givaudan AG**, which is the largest supplier of flavors and fragrances. Its end markets are wide ranging from food, household products such as soaps detergents, personal care products and fine fragrances. Its regional exposure is also well diversified across both the developed (60 per cent) and emerging (40 per cent) markets. We view this industry as low risk given the consolidated nature of the market place, high barriers to entry and key value enhancer of the end consumer products. Normalised top line growth for the industry is a stable two to three per cent per annum, while for Givaudan, it is four to five per cent per year. The company's ROE is currently at 10%, while operating margins range between 18 to 20 per cent. It is trading currently at 16 times 2012 earnings and we have a target price of CHF 940 reflecting a long term growth rate of 2.5 per cent and a cost of capital of seven per cent.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Staples	Overweight	Unilever
Consumer Discretionary	Neutral	Eutelsat Communications
Energy	Neutral	Tullow
Financials	Underweight	HSBC
Healthcare	Overweight	Fresenius SE & Co
Industrials	Underweight	WEIR
Information Technology	Overweight	SAP
Materials	Neutral	Randgold Resources
Telecom Services	Overweight	Vodafone
Utilities	Overweight	E.ON AG

ASIA EX-JAPAN

Equity Strategy

Given the uncertain global economic backdrop, our strategy is to remain defensively focused. We expect that the operating environment in Asia will be challenging in the next quarter. Inflation across the Asian markets is moderating, although we believe that this may not be enough to offset the deteriorating growth environment. Domestic consumption, which has hitherto held up and provided support for the Asian economies, has started showing signs of slowing. We expect that there will be more downgrades to companies' earnings as growth slows. Cyclical sectors, which are more susceptible to a global slowdown, could see further downside. The key risks include a major unraveling in the European debt crisis, the US going into a double-dip recession and a hard landing for China. Our strategy is to overweight the defensive sectors, which include Consumer Staples, Utilities, Healthcare and Telecommunications and underweight the cyclical sectors such as Energy, Industrials, Materials, Real Estate, Financials, Consumer Discretionary and Technology.

The macroeconomic indicators in Asia have deteriorated again in the most recent month after a slight rebound in October. The latest PMI in most Asian economies including China, Japan, Korea, Singapore and Taiwan are showing contraction, while the leading New Orders PMI are also mostly showing contraction. On a positive note, inflation in most Asian economies has come off, except for India where prices remain sticky.

In terms of valuation, the market is currently trading at attractive levels. MSCI Asia ex-Japan is trading at a 0.5 standard deviation below 14-year mean price-to-book levels. On a price-to-earnings valuation metric, the market is trading at more than one standard deviation below ten-year mean levels. Earnings estimates have also been revised down significantly, although we do not rule out that there could be more downward revisions. In terms of our sector position, we favour sectors that are relatively more defensive such as the consumer staples sector, telecommunications and utilities/toll road operators.

Within the consumer sector, the outlook for the discretionary subsector is deteriorating. Consumer discretionary spending is slowing down in most countries especially in China. The slowdown is noticeable in most discretionary segments and we believe that this will continue for at least the next quarter. For example, among the Hong Kong/China home appliance retailers such as Gome and Suning, same store sales have fallen from more than 20 per cent growth in early 2010 to single-digit growth rates in the first half of 2011. A similar situation is seen in Taiwan where same store sales growth has slowed from between seven and 11 per cent in the first part of this year to just one per cent in recent months. Among retail sales product categories, luxury goods seem to be the most vulnerable in a downturn while cosmetics was the least volatile.

Against the consumer discretionary subsector, consumer staple stocks have thus far outperformed this year though most companies in the subsector have seen their margins contract due to higher raw material prices. The outlook is more positive for the consumer stocks in the next quarter, not only because they have a more defensive earnings profile, but also due to the fact that they are likely to see margin expansion as raw material prices decrease. The key risk for positioning in the staples segment is that valuations are expensive while the discretionary segment is cheap, though earnings might still surprise on the downside.

We favour the telecommunications sector given that companies in the sector in general have stable free cash flow and dividend yields. We see stability and yield as key considerations in the current uncertain environment. A handful of telecommunication companies also offer growth catalysts. Data penetration is another catalyst due to the additional revenue contribution without large operating expenditure being incurred. Smartphone adoption is mostly beneficial to the telecommunication operators, driven by incremental average revenue per user (“ARPU”) and better margins. We like stocks which are gaining market share, have good management quality, consistent cash flows, good yields and data network capability. The key risks in the sector include handset subsidies that could rise out of proportion, new capital expenditure cycle to cater for the rollout of new 4G network, changes in government regulation that could hurt the competitive landscape for telecoms, and earnings before interest, tax, depreciation and amortization (“EBITDA”) margins softening due to commoditised voice call rates.

In line with our defensive stance, we also prefer the utilities sector. We favour the thermal utilities in Hong Kong and India for their regulated returns business and do not like the China coal independent power producers (“IPP”) as the policy environment is against them. We also like the toll road operators for the defensive utilities-like earnings profile. The sector is trading at an all-time high dividend yield, coinciding with trough valuations, which makes the Chinese toll road players very attractive.

In summary, given our cautious view of the Asian market, whose trajectory will be largely determined by global macro developments (in particular, the outcome of the European debt crisis), we position our portfolio defensively. We are overweight in the utilities, telecommunication, consumer staples and healthcare sectors and underweight the energy, material, real estate, financials, industrials, technology and consumer discretionary sectors.

Key additions to the Model Portfolio

ITC Ltd

The India-listed conglomerate ITC Ltd has consumer businesses spanning tobacco, hotels to paper and packaging products. The company is seeing a structural increase in volume growth in the recent years from about 15 per cent to 18 per cent. It is also seeing positive momentum on margins from increased volumes and an increase in premium of their products. Their fast-moving consumer goods (“FMCG”) business is also seeing a turnaround after 10 years of losses. This is likely to be another growth driver for the company in the long run. We view the business to be defensive in nature as well as having good growth potential in the next three to five years. Valuations are reasonable at 25 times estimated price-earnings ratio in 2012 and return on capital of about 32 per cent.

ENN Energy

Hong Kong-listed ENN Energy (formerly known as Xinao Gas) is an organic growth story in the downstream city gas distribution business in China. ENN is one of the key beneficiaries of China’s increasing focus towards clean energy such as natural gas. The company is currently the largest private sector player with a presence in 100 projects on an exclusive basis during the concession period. Compared to its peers, we like ENN for its higher exposure to commercial and industrial customers where it is easier and faster to get local government’s approval for a tariff hike in the event of rising gas prices, unlike for residential customers where social objectives may prevent governments from allowing a tariff hike.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer	Overweight	ITC, Hyundai Home Shopping
Industrials	Underweight	Shenzhen Expressway
Conglomerates	Overweight	Hutchison Whampoa, Sembcorp Industries
Financials	Underweight	Shinhan FG, Bank Mandiri
Property	Underweight	Mapletree Commercial Trust
Technology	Underweight	TSMC, Hon Hai
Telecoms	Overweight	Smartone, China Tel
Materials	Underweight	China Resources Cement
Energy	Underweight	Shenhua Energy
Utilities	Overweight	ENN Energy
Healthcare	Overweight	Celltrion

JAPAN

Strategy

Leading economics indicators for Japan continue to trend downwards, and point to slower real GDP growth in the next few quarters. Corporate earnings are also being revised downwards. The reasons for these include weakening external demand, triggered by intensification of the Euro zone debt crisis, policy tightening in China, and sharp appreciation of the Yen, and the flooding in Thailand.

Going forward, events in Europe will continue to influence the direction of global equity markets. While our base case assumption is that policymakers will eventually succeed in keeping the Euro zone intact, there remains the tail risk of a disorderly breakup. A Euro zone break-up is likely to cause the bloc to experience a sharp economic downturn and tip the rest of the world into recession.

Japan is unlikely to escape unscathed, although the boost from a third supplementary budget, that includes ¥9.1 trillion in initiatives to counter yen appreciation and fund earthquake reconstruction projects, may partly help to cushion the negative impact.

Under a global recession risk scenario, we think there is room for profits to decline further. Currently, consensus estimates still appear optimistic with TOPIX net earnings per share expected to rise by 12 per cent year-on-year in financial year of 2011, and 25 per cent in the financial year of 2012.

Share prices, on the other hand, seem to have already discounted a severe earnings outlook. TOPIX price-to-book multiple of 0.88 times is almost breaching the 2008-2009 global financial crisis' low of 0.8 times.

Key additions to the Model Portfolio

Although the market appears undervalued, any sustained rebound would require a bottoming out of both economic and earnings indicators. We are also watchful of any positive developments such as credible measures adopted at the EU summit meeting on 9 December 11 to address the Euro zone debt crisis, and further monetary loosening policies in China and the rest of Asia.

In view of the highly uncertain macro outlook, we would maintain our defensive stance for now. We are overweight in Consumer Staples, neutral Industrials, Materials, Technology, Financials, Energy, and underweight Utilities, Pharmaceuticals, and Consumer Discretionary.

We would adopt a bottom-up stock-picking approach, favouring quality companies with structural drivers, and high dividend yield stocks.

We have made minimal changes to the model portfolio during the quarter. Within the **Materials** sector, we removed **Nitto Denko** from the model portfolio due to concerns about slower-than-expected recovery in demand for LCD related materials, particularly that of TV polarizer films. While the current robust demand for indium tin oxide (“ITO”) film from touch panel application could help mitigate the impact, technology changes which include the use of in-cell touch panels and shift in display demand from LCD to OLED poses as threats to longer term growth prospects.

Within the **Industrials** sector, we removed **Mitsui OSK**. The shipping sector remains structurally challenged due to overcapacity issues and opaque outlook. While conditions in the bulk segment have recovered, containership and tanker rates remain weak due to growth in supply and slowing demand from developed economies.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Underweight	Nissan, Honda, FCC, ABC Mart, Asics
Real Estate	Neutral	Mitsubishi Estate
Energy	Neutral	Inpex
Financials	Neutral	Bank of Yokohama, Suruga Bank, Sony Financial
Materials	Neutral	Ube
Technology	Neutral	Hitachi, Toshiba, Yahoo Japan
Industrials	Neutral	Mitsui & Co., Komatsu, Fanuc
Healthcare	Underweight	Sawai Pharmaceutical
Consumer Staples	Overweight	Sundrug, Toyo Suisan
Info-Comm	Neutral	Softbank
Utilities	Underweight	Tokyo Gas

CHINA

Strategy

The China stock market is facing a number of headwinds, as growth is set to slow further as seen from the weakening leading indicators. Also, exports are set to dip as growth in developed markets falls off. Moreover, beyond the negative external developments, the “new normal” in China is likely to be lower growth and structurally higher inflation than what we saw in the past decade, as China’s favourable demographic trend reverses and rising wage expectations become embedded.

Perhaps the greatest risk now is the potential turbulence in the real estate segment, as property sales and prices fall with knock on effects on the financial system and economy.

On a more positive note, moderating inflation will give the Chinese authorities more room to loosen policy. China has already unveiled selective easing measures such as credit support for small and medium sized enterprises, pilot launches of local government bonds and the latest reserve requirement ratio cut at the end of November. Nonetheless, although we expect some more selective easing measures, it will not likely be of the same magnitude as the stimulus that we saw at the end of 2008 and 2009. The investment and monetary imbalances in China have escalated over the last decade, more so since the previous large scale stimulus program. Hence, the government is wary of the arising distortions and inflationary consequences.

In recent years, the systemic risk in China’s financial industry has also increased. Local government debt has escalated and much of the proceeds spent on infrastructure projects will take a long time to break even. A sizeable chunk of these loans could become non-performing. There has also been a large rise in informal lending and off balance sheet financing such as trust products, much of which has been channelled to property and local governments. As properties prices and sales fall, developers’ cash flows will be strained and this has knock on effect throughout the financial system and economy.

Valuations of the China market on price-to-earnings and price-to-book are attractive, close to the low points during the 2008 global financial crisis. We see a dichotomy developing in the market, with the financial sector having de-rated and staying cheap, while the non-financial sector with healthier structural growth has a better chance to re-rate.

In this regard, we see opportunities in selected areas of infrastructure spending that will see a pick up next year, such as nuclear power, railways and telecom capital expenditure. We also target the strategic industries that are the focus of China’s 12th five-year plan such as water treatment and environmental protection. We continue to like the consumer sector, which will benefit from structurally rising wages and policy tailwinds. However, we prefer to focus on the mass market consumer rather than the high end, luxury segment. Hence, we have broadened our exposure beyond the discretionary segment to staples, telecoms and technology. We are underweight in cyclical sectors such as materials and energy, as well as the banks and property sector, which will come under pressure from the ongoing property correction.

With all the ongoing headwinds, we are cautious on the market and defensively positioned at this point, although a lot of the negatives have already been priced in. A key signal that will make us turn more positive on the China markets is when the property prices stabilise and the economy and banking system prove resilient enough to handle the correction. That will remove the major overhang on the market now.

MODEL PORTFOLIO

SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Overweight	Haier Electronics, China Lilang
Consumer Staples	Overweight	China Mengniu Dairy
Industrials	Overweight	Shanghai Electric, China Everbright International
Financials	Underweight	Ping An Insurance, ICBC
Property	Underweight	China Resources Land
Technology	Overweight	Tencent Holding
Telecoms	Overweight	China Telecom, Comba Telecom
Materials	Underweight	China Resources Cement
Energy	Underweight	China Shenhua
Utilities	Overweight	China Resources Gas
Healthcare	Underweight	NA

ASEAN

1Q12 Equity Strategy

The first quarter of 2012 is likely to be marked by continued uncertainty and volatility in capital markets. Furthermore we expect global economic growth to weaken in 2012 and this will have a corresponding adverse impact on the ASEAN economies. During the previous downturns, however, ASEAN appeared to be relatively more cushioned from external economic shocks when compared to their North Asian counterparts. The main reason for the region's resilience is the high level of domestic consumption as well as low dependence on exports. This is especially true for markets like Indonesia, Philippines and Thailand. In 2011, ASEAN again outperformed as investors sought safety in the regional markets. Going into 2012, we believe that ASEAN will continue to perform well in an uncertain and volatile market environment.

From a country perspective, we are overweight in Thailand, Singapore and the Philippines and have a slight underweight on Indonesia. We maintain our underweight stance on Malaysia. We continue to focus on key structural themes within each ASEAN country where the pan-Asean themes of consumption, infrastructure and commodities remain intact.

At a sectoral level, we are overweight in Consumer Discretionary, Consumer Staples, Energy, Real Estate (primarily REITs) and Industrials sectors. We are underweight the Financials and Materials sectors.

MODEL PORTFOLIO

SECTOR	WEIGHT	TOP PICKS
Consumer	Overweight	Genting Bhd, Indofood CBP, Golden Agri Resources, KL Kepong
Industrials	Neutral	Keppel Corp, STX OSV
Financials	Neutral	Bank Mandiri, Bank Rakyat, Public Bank
Property	Overweight	Mapletree Commercial Trust, Asian Property Development
Telecoms	Underweight	SingTel, Advanced Info, PLDT
Materials	Underweight	Semen Gresik
Energy	Overweight	Sakari, PTT
Utilities	Underweight	Energy Development Corp

SINGAPORE

1Q12 Equity Strategy

Within ASEAN, Singapore is the most susceptible to external demand shocks given its export-oriented growth model. The slowdown in global indicators is expected to exert downward pressure on ASEAN markets, with a correspondingly larger adverse impact on Singapore.

Going into the first quarter of 2012 we continue to adopt a defensive investment stance. We favour the defensive sectors like Telecoms and Real Estate (REITs), given the attractive dividend yields offered by these sectors.

We maintain our strategy of being underweight in the cyclical sectors like Financials (Banks) and Industrials as we are concerned over the earnings impact from slower external demand. We also hold a cautious view of the Real Estate developers given the policy headwinds, as illustrated by the government's latest property measures in December 2011.

However as valuations in Singapore have reached levels which appear to price in a mild downturn – though not a global crisis – we remain vigilant and await the opportunity to invest into high quality blue chips at the appropriate time.

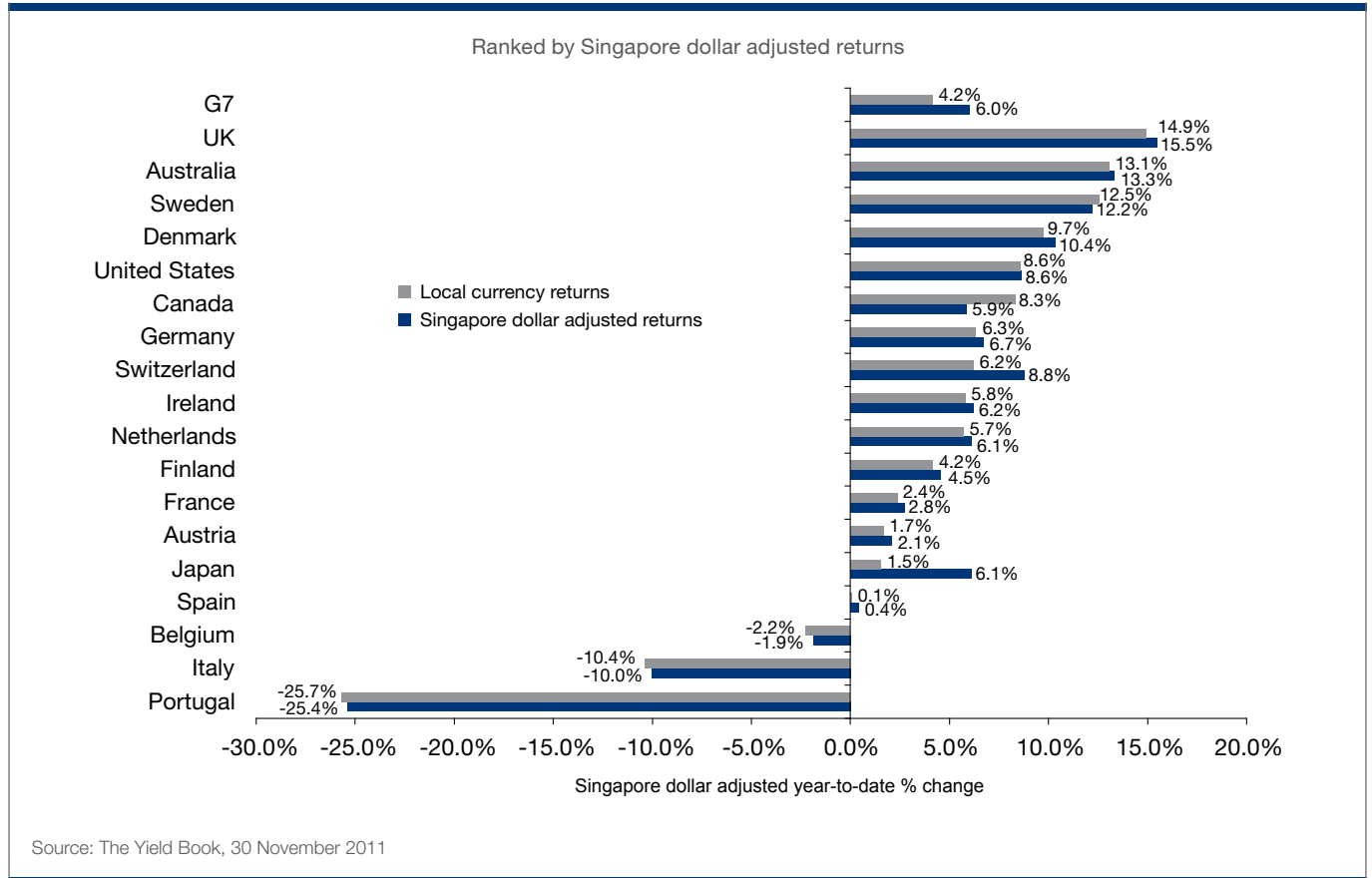
MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Underweight	Genting Singapore
Consumer Staples	Overweight	Wilmar, Golden Agri
Financials (Banks)	Underweight	DBS, OCBC
Financials (Real Estate)	Overweight	Mapletree Commercial Trust, Global Logistics Properties
Healthcare	Underweight	-
Industrials (Capital Goods)	Neutral	Keppel Corporation, STX OSV
Industrials (Transportation)	Underweight	Comfort Delgro
Information Technology	Neutral	-
Telecommunications	Neutral	Singapore Telecom

GLOBAL FIXED INCOME STRATEGY



GLOBAL FIXED INCOME STRATEGY

Bond Market Returns



G-10 FIXED INCOME

Outlook and Strategy

The G7 Government Bond index has returned six per cent so far this year in Singapore dollar terms. All member countries posted positive contribution except for Italy. We saw better returns in Singapore dollar terms in most countries including UK, Japan and Euro zone nations as their local currencies appreciated against the Singapore dollar. Their yields continued to trade at an all time low as investors sought “safe haven” in the non-Euro government securities. Although, we expect US, Japan, Canada and UK to continue to trade at low yields due to flight-to-quality, weakening investor confidence towards the core Euro zone nations is likely to take the core Europe yields higher in the coming quarter.

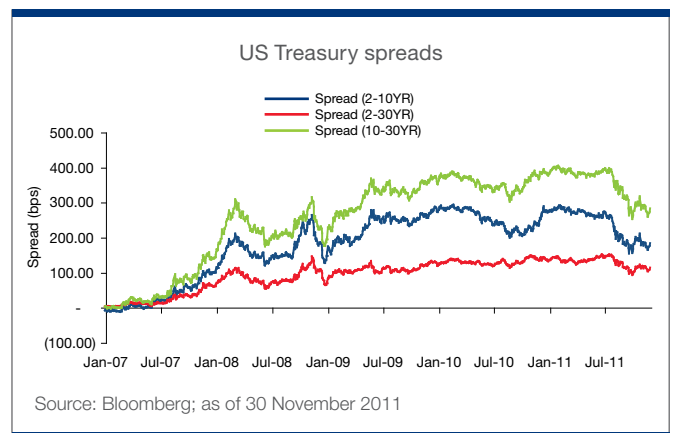
A worsening of the European sovereign debt crisis has accelerated the flight-to-quality into US treasuries this year, keeping the yields 50-60 basis points below their fair values. Although the domestic economic data in US has surprised on the upside, the converse is true in Europe, where the Euro zone debt crisis has spread from the smaller peripherals to the much larger bond markets of Italy and core Europe. This has kept the US Treasury rates broadly range bound in the fourth quarter of 2011.

The low yields have also been well supported by Fed's accommodative policies. The two year rates have been at the low levels since the Fed announced its intention to keep the Fed fund rate near zero percent till 2013. The Fed has also launched operation Twist which will last till June 2012. The program will see the duration of its balance sheet being extended by switching to longer duration bonds. Hence, the 10-year to 30-year segment of the yield curve has flattened and is expected to continue the trend in the coming quarter.

The US GDP growth for the third quarter showed significant improvement coming at two per cent quarter on quarter after 0.4 per cent in Q1 and 1.3 per cent in Q2. The expectation for the current quarter is above two per cent given the improvement in the auto sector as Japan recovers and consumer spending was up due to the holiday season. But as contribution from the auto sales fades and households, banks and public sector continue with their deleveraging process, the GDP growth rate in the first quarter of 2012 is expected to be sub 2 per cent. With growth likely to remain sluggish as fiscal drags come into play and unemployment remains high, we look for the Fed to use another round of QE, with asset purchases in mortgage-backed securities, as a possible tool.

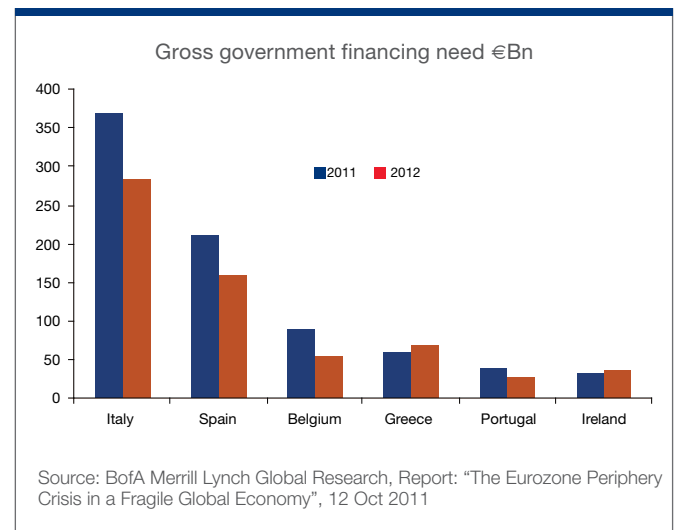
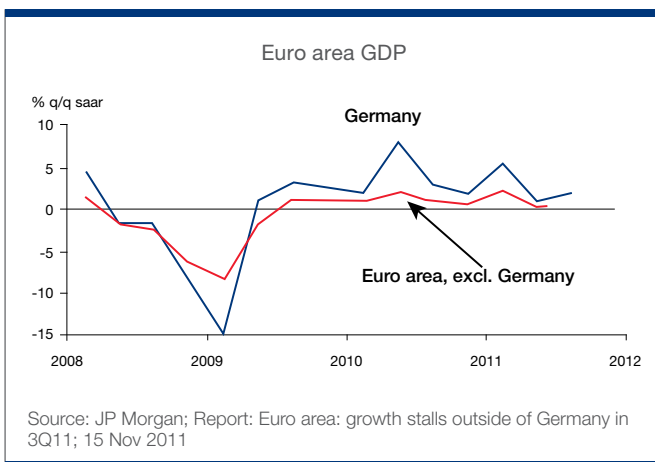
The US fiscal situation is expected to be stable in 2012. After the US\$900 billion cuts were agreed in August another US\$1.2 trillion of automatic spending cuts are expected to be made as the Deficit Reduction Committee failed to reach an agreement. In order to stabilise debt levels, we estimate Congress still needs to reduce the structural deficit by additional one percentage point of GDP per year. But 2012 being an election year these further cuts are expected not to be implemented before 2013. Though the rating agencies maintained the ratings after the failure of the "Super Committee", Fitch has moved to a negative outlook while affirming its AAA rating.

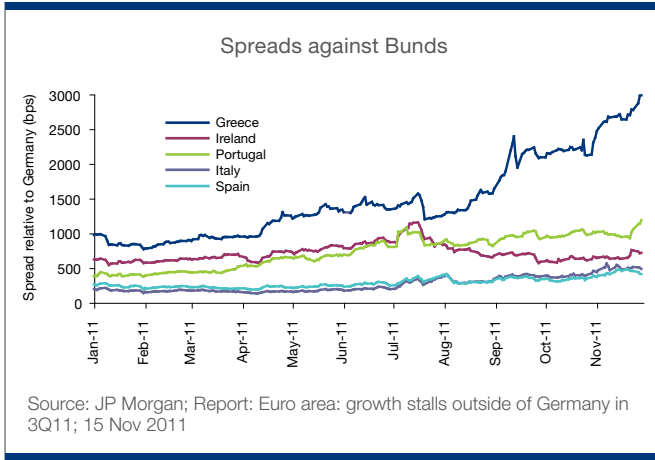
Modest GDP growth along with acceleration in flight to quality due to the European sovereign debt crisis will cap the rise of US treasury yields. Also, the long-term inflation expectations remain relatively stable. We foresee ten year Treasury rates to be range bound between 1.85-2.50 per cent in the first quarter of 2012. We are long in duration given the Fed's duration buying program will keep the curve flat. Also, we are overweight US dollar, given the improving economic data and another round of QE not an immediate possibility.



The failure of the EU authorities to find a solution to the sovereign debt crisis has significantly increased the risks of a recession in the Euro zone. The steady fiscal austerity in the larger member states, deteriorating bank credit supply and rapidly deteriorating confidence, point towards a deepening contraction in economic activity in the next few quarters. As the crisis has spread over the last few months into the larger peripherals and even the core, the need for fiscal consolidation from large Euro area members has increased. Austerity in these larger member states, such as Italy and France, weighs much more on Euro area economic prospects than austerity in smaller countries.

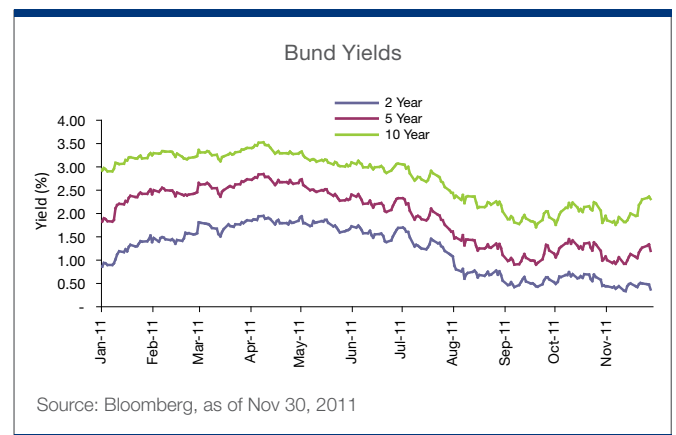
Italian and Spanish bond yields continued to be high this quarter even as the ECB declined the role of the lender of the last resort. The ECB is concerned about issues of moral hazard in bailouts where countries have fewer incentives to carry out difficult reforms, if there is an easy way out. In our view, however, the likelihood that the ECB might step in is inching higher despite its public rhetoric to the contrary. Although the change in governments in Italy and Spain did not reduce investor risk aversion towards their debt markets, the developments offer a ray of hope in the near term. Italy has started on the right note by beginning emergency austerity and growth plans for the economy, while Spain's pension and labour reforms are underway and its new government will soon bring needed austerity mandates. So far Italy's problem is one of liquidity, not solvency, but further delays in decisive policy actions could eventually turn the liquidity problem into solvency problem. Italy and Spain together need to raise over €430 billion in the market in 2012 and with yields close to seven per cent and growth continuing to be weak, sustainability without a backstop solution is difficult. A positive development in this direction was the approval to maximise EFSF's capacity by Euro area Finance Ministers by introducing sovereign bond partial risk participation, but details of the amendments remain to be discussed.

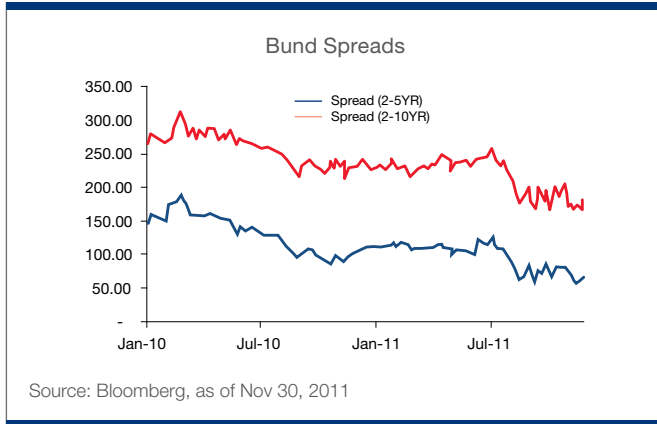




Growing concerns over contagion risk has threatened to take the crisis to a new level. Lately, there has been a significant rise in French bond spreads compared to the bunds, rising from 70 basis points to 110 basis points this quarter. If a further rise in bond yields or large bank losses leaves France unable to support the periphery, the burden on Germany and the few remaining “core” economies might become too heavy to tolerate. These concerns have also raised the possibility of its sovereign downgrade, which will endanger EFSF’s AAA credit rating. Although France has approved a new ambitious austerity package to gain back investor confidence, its yields remain higher than most other AAA nations. Investors concerns have been increasing towards the entire Euro zone with not many exceptions even to the “core” nations. Recently, Germany has had a few weak bond auctions in the primary market and since then its yields have been on a rise. Also, Germany continues to remain opposed to ECB’s intervention in the financial markets and is determined to create a legally enforceable fiscal union to restore confidence in the Euro zone.

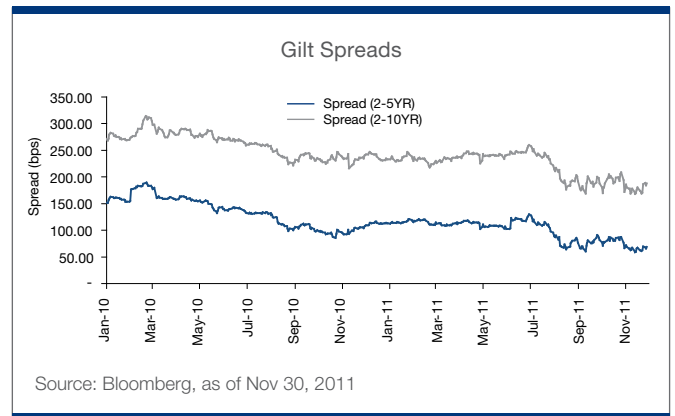
The end-game for Greece has been playing out for quite some time now, and the situation still has the potential to cause further market disruptions and needs more focus than it’s currently being given. The country has continued to lag its growth and fiscal targets. Its GDP is currently tracking at 6.5 per cent year-on-year decline and deficit of 9.6 per cent of GDP for 2011 compared to original targets of -2.6 per cent and 7.6 per cent respectively. Developments towards the second bailout package and finalising the private sector involvement (“PSI”) details for Greece have been extremely slow. Though, the Euro zone has agreed to release the sixth tranche of loans to Greece and should be disbursed by mid December. Portugal also had its second review by Troika, which indicates that it is likely to miss its budget deficit target of 5.9 per cent for this year and given the global headwinds hampering exports, a recession in 2012 will be more pronounced. Hence, the success of the program crucially depends on the continued implementation of reforms. Ireland’s recovery on the other hand is going as per plan and the markets are decoupling it from the other program countries.





Given the shift in investor confidence towards core Europe, we believe that the widening of spreads will continue. Hence, we are underweight in France and Germany, but are neutral towards Italy against the benchmark given the current yield levels. We are short on duration in Bunds as we expect the curve to steepen from here. We are underweight on Euro as the deterioration of the sovereign debt crisis will put pressure on the currency as well.

In UK, the growth prospects continue to remain poor with inflation coming under control. Hence we expect the monetary policy to stay accommodative and the Bank of England to engage in further quantitative easing. Gilts are a viable safe haven alternative during these periods of turmoil, and will likely outperform US Treasuries and Bunds in the coming months. We expect the 10-year yield to continue to be low and trade range bound between 2-2.50 per cent. We are overweight in Gilts, staying long in duration as we expect the curve to flatten given more likely Quantitative Easing by Bank of England (BoE). We are maintaining an underweight in GBP as we don't foresee BoE changing its accommodative stand anytime soon.



In recent months, Japan's industrial activities had gradually returned to close to pre-earthquake level. However, the sustainability of the recovery could be threatened by the escalating European sovereign crisis and downward revision of growth expectations which would further lead to more cautious consumer and investment spending. The floods in Thailand in October again created disruption in the supply chain and is another potential source of headwind for industrial activities. Japan's current account surplus could shrink due to slower external demand driving lower exports, relocation of manufacturing plants as domestic production get squeezed by power shortage and loss of competitiveness from yen appreciation and lower investment returns on overseas assets. However, the reconstruction demand is likely to provide the boost needed for the domestic economy.

Despite the challenges that Japan is facing, the yen strengthened to a historical high against the US dollar before the Bank of Japan intervened unilaterally in the foreign currency market at end October. The yen strength was due to the low yields and concurrent easing by the various central banks. Since 2010, the correlation between dollar-yen rate and interest rate differential has declined, possibly driven by low absolute yield. In the longer term, however, yen is likely to weaken when the relationship between currency and interest rate differentials strengthens again. Correlation between VIX index and dollar-yen has increased, suggesting that the fear factor in the market is a significant driver of the currency. Despite the high government debt to GDP, the yen still has an appreciating bias which is supported by external factors and its strength as a current account surplus country. The tough stance taken by the Swiss authorities on Swiss franc has added to the yen's allure for investors.

Fiscal consolidation is a long process for Japan and progress has been hampered by political hurdles delaying timing of tax and structural reforms. Japan's fiscal situation has so far been sheltered by high domestic investor base and low funding costs. The European experience has showed that once confidence is shaken, borrowing costs will escalate and it is a downward spiral that will get increasingly harder to contain. In view of the reasons discussed, we would maintain an underweight position in Japanese government bonds and stay neutral on the currency.

The Reserve Bank of Australia ("RBA") reduced the policy rate by 25 basis points to 4.5 per cent in November after holding it steady for a year. The central bank is responding to the increase in downside risks for the global economy by neutralising the slightly restrictive monetary policy.

Australia is a two-speed economy with diverging developments in the resource and non-resource based industries. In recent months, employment growth has been subdued in both resource and non-resource states. Capacity utilisation had peaked and is drifting lower. Underlying inflationary pressure is on the decline and overall inflation rate which shot up due to large increases in utilities charges is expected to decline sharply over the next few quarters as food prices fell. While there is room to ease monetary policy further, the magnitude of cuts is not expected to be aggressive compared with the previous easing cycle. Indices tracking economic activities in the manufacturing, services and construction sectors are showing downward trend. The policy rate is at a level which is fairly consistent with where the manufacturing and services indices are. The construction index is slowing more sharply. House prices in Australia have been declining in recent months. Nonetheless, the downside is supported by supportive fundamentals. The housing market is still facing a shortage with constructions outpaced by strong underlying demand.

Bond yields declined sharply and have priced in further rate cuts from the RBA. The Aussie has been among the most overvalued currencies and is likely to correct in an economic downturn. We have a neutral stance on bonds and underweight the Australian dollar.

In the second quarter, the Canadian economy was held back by weaker exports partly due to supply chain disruptions and constraints in the energy sector. Despite some rebound in the third quarter after unwinding of some temporary negative factors, the outlook for Canada has weakened. The key risks for Canada come from close trade links with United States and the importance of commodities to its economy as we see slower global growth expected ahead. The central bank expects growth in Canada to slow through mid-2012. Domestic demand is expected to be the main driver of growth albeit at a more subdued pace with household spending more modest as commodity prices and financial market volatility weights on confidence, income and household wealth. The improvement in the labour market has stalled in recent months and is at a 7% handle. Net exports could face headwinds from weaker foreign demand, lower commodity prices and relative strength of its currency. Investment is expected to be subdued but supported by still favourable credit conditions and the pressure to become more competitive. Headline inflation expectation is also projected to be lower to trough at around one per cent by the middle of 2012 before rising as excess supply in the economy is slowly absorbed.

The Bank of Canada hiked the policy rate from 0.25 per cent to one per cent between June and September 2010. With tighter monetary policy and fairly supportive oil prices, the Canadian dollar has been relatively resilient. Going forward, the central bank is unlikely to tighten monetary policy against a fragile global economic outlook. However, it would still take significant loss of global economic momentum to convince Bank of Canada to take the policy rate down to recent historical low. Housing prices have recovered after a slight dip during the Great Recession. High domestic leverage as reflected in the alleviated house price-to-personal income ratio and total debt-to-personal income were concerns. Tighter mortgage rules had been implemented before they become a risk to the financial system as what we saw in the United States and elsewhere. However, borrowing costs for households and businesses remain at very low levels. Reducing policy rate which is currently at a still low one per cent will unwind the efforts made and thus it is unlikely that the Bank of Canada will loosen monetary policy at this point. We have a neutral stance on bonds and underweight Canadian dollar.

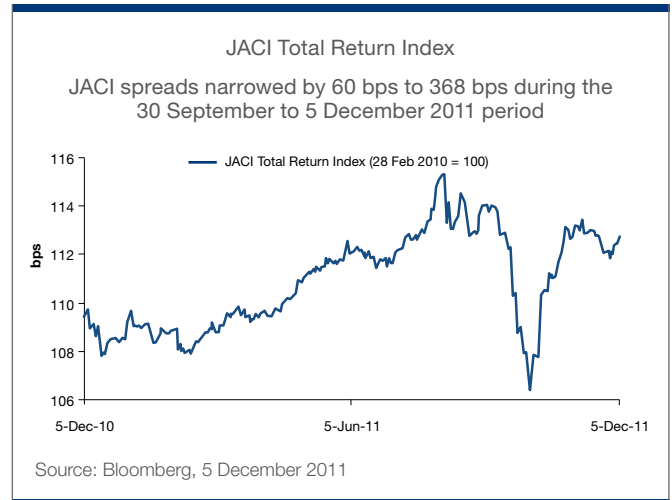
ASIA FIXED INCOME

Outlook and Strategy

In the fourth quarter of 2011, the Asia credit market rallied with spreads tightening 60 basis points (“bps”) to 368 bps as at 5 December 2011, after widening by 157 bps in the third quarter of 2011.

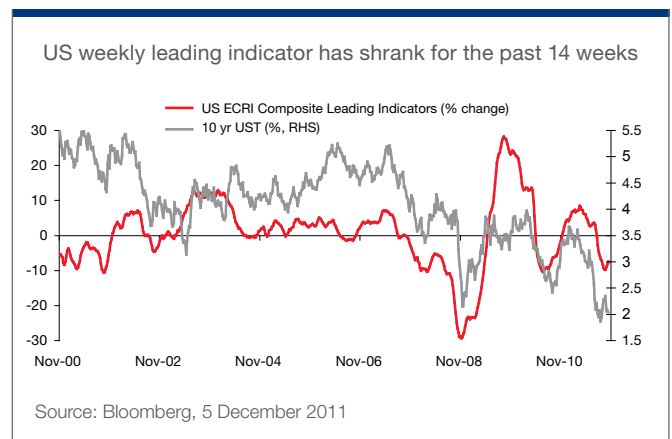
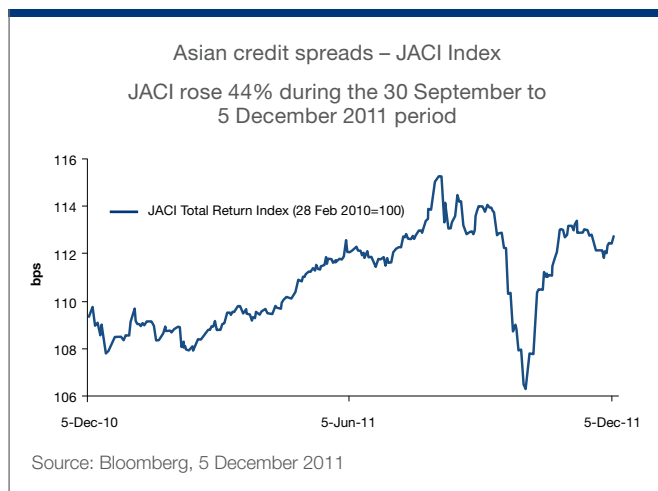
With US Treasury yields rising 14.6 bps (10-year UST yield rose 15 bps to 2.06 per cent in Q3), the JACI total return index (including accrued interest and in US dollar terms) rose 4.4 per cent in Q4 2011 from -3.4 per cent in Q3 2011. This takes the year-to-date total return to 3.8 per cent in US dollar terms.

At a spread of 368 bps as at 5 December 2011, the Asian credit market is pricing in real GDP growth of around 5 to 5.5 per cent for Asia. We estimate that growth in Asia is likely to average 4.5 to 5 per cent over the next 12 months. According to our model, this suggests that the fair value spread for Asia credit should be around 430 bps. Hence, this suggests that the Asia credit market is currently over-valued by around 60 bps even with spreads having widened so sharply over the past few months.



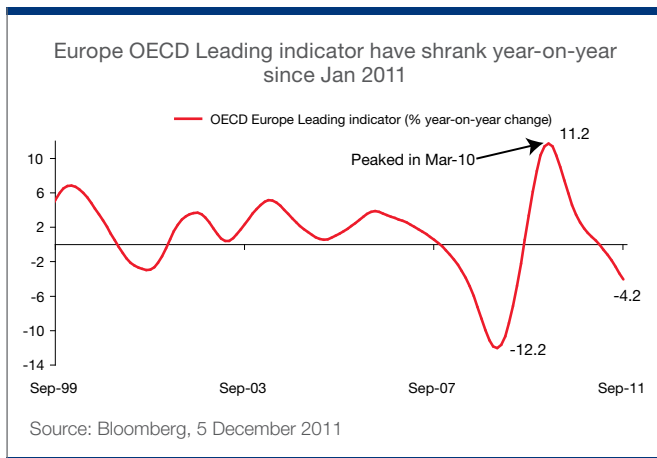
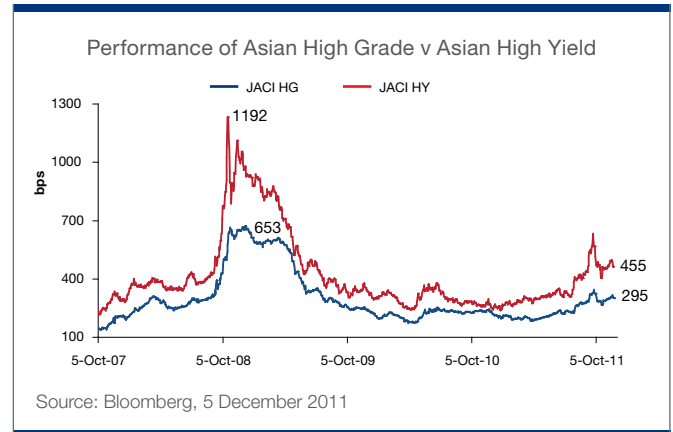
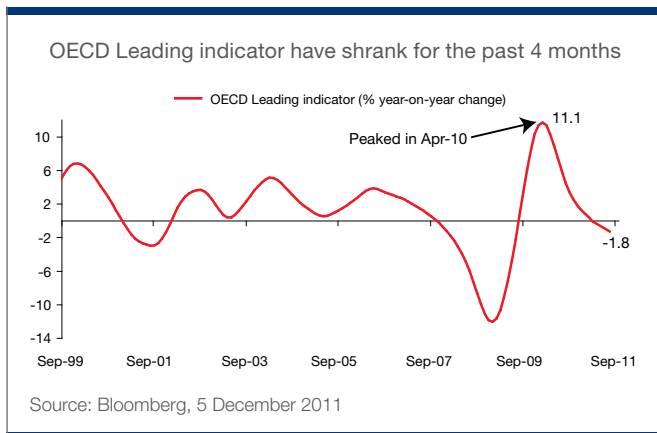
We expect Asia credit spreads to widen further over the next one quarter to around 430 bps in the first quarter of 2012 versus 368 bps in the fourth quarter of 2011 as growth in Asia begins to slow sharply. Hence, we believe that Asia credit spreads could widen 60 bps from here over the next three months.

Meanwhile, leading indicators are suggesting that the US and European economies are weakening. The ECRI Leading indicator has shrunk for the past 15 weeks. The latest reading of -7.8 per cent as at 25 November 2011 suggests that the US economy probably stalled in the fourth quarter of 2011.



Meanwhile, the OECD Composite Leading Indicators (“CLI”) in September is also pointing towards further moderation in global growth. The CLI for Europe, US and China all weakened in September. The headline OECD CLI fell for the fourth consecutive month to -1.8 per cent year-on-year in September versus 1.4 per cent year-on-year in August. The Europe OECD CLI continued to deteriorate sharply in September, falling 4.2 per cent year-on-year from -3.5 per cent year-on-year in August. The sharp fall in Europe OECD CLI, together with Europe PMI falling to 46.4 in November (fourth consecutive month that PMI went below 50), suggests that Europe is likely in a recession now.

Given the sharply slowing global economic growth over the next three to six months, we think that ten-year UST yield is likely to stay at close to two per cent over the next two quarters.



We are positioning our portfolio defensively via an overweight position in investment grade credits and an underweight in non-investment grade credits. We continue to adopt a barbell strategy of buying short duration (with maturity under 18 months) high yield bonds and long duration high grade bonds as these two kind of bonds tend to be more resilient in times of heightened risk aversion.

In **High Grade**, we are overweight in China, Hong Kong, Singapore and Australia High Grade corporates. These credits include **China National Petroleum Corporation, Malaysia government, Henderson Land, PCCW, China Overseas Land, Singapore Power, China National Petroleum, Port Authority of Singapore and National Wealth Management, and Kerry Properties**. These companies offer decent yield pick-up over similarly rated credits and duration without a compromise in credit quality.

In **High Yield**, we continue to prefer good quality corporate bonds like **MIE Holdings, Berau Coal, Bumi Resources, Yanlord, Franshion, Indika, Shanshui and Country Garden** that have strong balance sheets and solid business models.

SECTOR	CREDIT OUTLOOK
Banks	<ul style="list-style-type: none"> Retreating European banks may offer strategic opportunities for banks, but we believe most credit implications are negative, although manageable. We expect the cost of wholesale funding to increase, credit access to decline and USD supply risk to increase. An orderly deleveraging of European banks' exposure to Asia, while manageable, will still have an adverse impact on the financial lending conditions in Asia in two ways: (i) fundamentally, reduced access to credit for corporates raises default risk, (ii) technically, reduced access to bank credit means more supply channeled into bond markets. The replacement of FX wholesale funding of European banks by Asia banks will increase supply already on the increase on the back of high FX loan growth. We see risk of FX bond supply from most Asia ex Japan banks, in particular Singapore, Hong Kong, Korea and India. We see further downside risks to Indian banks as financial profiles are the most challenged amongst Asian banks. This is particularly the case for state-owned banks as a weak fiscal position constrains the government's ability to inject capital to support balance sheet growth. Indian banks' asset quality will be under pressure given the difficult macro economic outlook in India. Indian banks are also among those most exposed to an increase in cost and deterioration in availability of FX wholesale funding on the back of European deleveraging.
Industrials	<ul style="list-style-type: none"> We recommend an underweight for High Yield Chinese industrials but we are selective on certain names in this space and continue to look for corporates operating in industries that are more resilient and in line with China's growth plans. Also, we look out for strong balance sheets and good business models. (SHASHU, FOSUNI, MIEHOL) We are overweight in Indonesian coal names (BRAUCIJ 15s and BUMIJ 16s, 17s) for good carry in a defensive sector. In the other parts of Asia, we are also cautious in the High Yield industrials sector as the tough capital markets have exposed and will continue to expose corporates with liquidity issues. We are slightly overweight on High Grade corporates in the overall industrials space as they tend to have better funding options in these tough conditions, stronger balance sheets, lower leverage and better liquidity. (We like CHINAM 15s, 18s, BEIENT 21s, 41s, NOBLSP 13s, ZIJMIN 16s, HYNMTR 17s, HUWHY 4.625 15s, 18s – bonds maturing in 2015, 2018 and 2027 will be rolled down to T2, T5 and T10 respectively from 2012.) We are underweight in Indian credits in general due to the Rupee's depreciation. This has taken a toll on the sector as it has underperformed due to concerns on credits with costs in USD and revenues in INR (IOCLIN 15s, 21s) with debts also denominated in USD. However, that said, credits like RILIN 20s, 40s have almost all its revenues quoted in foreign currencies and the recent underperformance of RILIN together with the Indian space provides a buying opportunity, in our opinion. (We like RILIN 20s, 40s)
Property	<p>Chinese Property:</p> <ul style="list-style-type: none"> We continue to remain cautious given continued policy headline risks in 1Q12. We recommend an <u>Under Weight on the segment with Over Weight in selective SOE linked and Tier 1 benchmark names</u>. We might look to add some position in stronger Tier 2 names on a tactical basis. We expect the long term demand for residential property will continue to be strong given rapid urbanisation and rising income levels. However, we remain cautious in the near term with policy uncertainties as an immediate overhang given the Chinese government's resolve to control property price inflation. The segment will continue to trade accordingly to headline news. <p>Hong Kong Property:</p> <ul style="list-style-type: none"> We are more constructive on the Hong Kong developers given that they have substantial recurring income base from their investment property portfolio. However, given that they also have increasing development exposure to China and the various tightening policies imposed on the Hong Kong residential market, we recommend a <u>Market Weight on the segment</u>. We have a preference for names with strong investment portfolio. We are seeing the Hong Kong developers raising funds in the Sing Dollar bond market, and hence beefing up their liquidity position as a result.
Oil & Gas	<ul style="list-style-type: none"> We like this sector for the continued increase in demand for oil and gas driven by growing Asian economies and hence we continue to overweight this sector. However, most of the corporates in this sector are looking to expand and are continually looking for assets to acquire globally and debt funded acquisitions will increase leverage significantly. (RILIN net cash position by FYE12, CNPCCH and PTTEPT looking to acquire oil and gas producing assets.) A mitigating factor is that most oil and gas names also tend to have government ownership in developing countries due to the importance of oil and gas and we expect huge government support for corporates operating in this sector. We prefer corporates with upstream capabilities in this space as refining margins have peaked and are expected to come down on large refining capacity coming online in 2012. (We like CNPCCH, PTTEPT and RILIN). In the downstream space, we look out for corporates with lower mid term capital expenditure plans and high utilization rates. We like GSSCOR for its unique ability to naturally hedge against lower refining margins through its petrochemicals business and its high utilisation rates at above 100%. GSSCOR is also 50% owned by Chevron Group.

SECTOR	CREDIT OUTLOOK
Utilities	<ul style="list-style-type: none"> • We like the utilities sector for its stable and defensive qualities and recommend an <u>Over Weight on this sector</u>. • We have a preference for names with the ability to readily cost pass through higher cost of production under stable and regulated tariff structures. • For gencos without the ability to readily cost pass thro, we are expecting some downward pressures on revenue and earnings, with corresponding slight decline in credit metrics. • We see higher risk of debt-funded expansion and investment plans in the near to mid term as gencos aim for vertical integration via acquisitions of stakes in energy sources/companies. Thus, we see potential supply risk in 1Q12 as companies take advantage of current low rates to issue bonds.
Consumer	<ul style="list-style-type: none"> • We are turning slightly cautious on this sector and recommend a <u>Slight Under Weight</u> as consumer spending and confidence will be impacted by the increasing uncertainty in the global economic outlook. We thus have preference for names whose businesses are not geared towards Western economies. • However in the Chinese consumer space, we think that discretionary spending will be supported by the various tightening measures in the property segment. Spending flows could be diverted into luxury goods segments as consumers seek a better lifestyle with raising income levels.
Quasi-sovereigns	<ul style="list-style-type: none"> • We remain constructive on the Indonesian quasi-sovereigns. As we believe Indonesia will soon attain investment grade status, we expect the ratings of these entities to be similarly upgraded. The enlarged class of investors who can invest in these securities should provide favourable technical dynamics. • We are neutral on the Korean policy banks. The systemic importance of the financial sector, together with the government's record of providing financial support, suggests that the Korean policy banks should trade in-line with the sovereign. We also expect them to trade in line with each other. We prefer bonds maturing in 2015 as we believe these bonds will capture a favourable roll-down. • We continue to like Temasek bonds given the rare AAA credit in the Asian fixed income space and reasonable spreads that it trades at compared to other AAA-rated SSAs.
Technology	<ul style="list-style-type: none"> • We are bearish on most technology-related companies. We continue to avoid technology companies that we believe have no competitive advantage. We remain cautious on semiconductor and related industries as these are cyclical industries. We are also extremely bearish on solar-energy related companies.
Telecommunication	<ul style="list-style-type: none"> • We view telcos in more developed markets as a defensive and stable play and recommend a <u>Slight Over Weight</u>; For telcos in developing markets, we view them as growth stories with large capex programs and thus recommend a <u>Market Weight</u>. • In the developed markets, we expect to see stable subscriber growth and increased average revenue per user, driven by the roll-out of new services, increasing use of smart phones/mobile devices, as well as mobile and broadband network expansion in most countries. In the developing markets, intense competition coupled with the need to constantly upgrade networks will see downward pressures on both income and balance sheets. • However, capital expenditures and operating costs could surge as telcos invest to build up their network and related service capabilities. We do not rule out the possibility of telcos tapping the market for debt – funded acquisitions or expansion plans. • We note that the National Broadband Network projects in Singapore and Australia could change the industry dynamics when it is up and running.

SINGAPORE FIXED INCOME

Fourth Quarter Review

MACRO REVIEW

The Singapore economy escaped a technical recession, with the third quarter GDP rising by 1.9 per cent quarter-on-quarter (seasonally adjusted and annualised basis) after a 6.4 per cent contraction in the second quarter. On a year-ago basis, real GDP grew 6.1 per cent in the third quarter from 1.0 per cent in the second quarter. The market consensus was looking for a 0.8% quarter-on-quarter rise and a 5.6 per cent year-on-year rise. The manufacturing sector was the key driver of growth in Q3 2011, rising 14.2 per cent year on year (“YoY”) and 8.9 per cent quarter on quarter (“QoQ”) SAAR. The strength of the manufacturing sector is due mainly 89.3 per cent year-on-year surge in biomedical output. Services slowed to 3.7 per cent year-on-year (-0.7 per cent QoQ SAAR) in the third quarter from a rise of 4.0 per cent year-on-year in the second quarter.

The government’s 2011 forecast growth of 5 per cent suggests that they are expecting a five per cent quarter-on-quarter SAAR contraction and for the year-on-year real GDP growth to slow to 4.0 per cent in the fourth quarter. We are actually more pessimistic for the growth outlook and expect growth to slow to 2.5 per cent in the fourth quarter of 2011 and a full year GDP growth of 4.5 per cent in 2011. The government warned that GDP growth could be much slower in 2012, possibly slowing to one to three per cent, which is below the potential rate of one to three per cent.

Our leading indicators like OECD Composite Leading Indicator and ECRI Leading Indicator continue to suggest that economic growth will slow in the first half of 2012. The sovereign debt crisis in Europe has likely made a big dent on global consumer and business confidence. While the risk of a recession in the US within the next two quarters has receded somewhat, we think that Europe has likely entered into a recession in the fourth quarter of 2011. With growth in US likely to be anaemic and Europe likely to have fallen into a recession, we think that there is a real risk that Singapore could post close to flat growth or even slight contraction in 2012.

With exports likely to shrink for a prolonged period of time, we think that Singapore dollar (SGD) is unlikely to appreciate further in the first half of 2012. Over the past 15 years, whenever NODX contracts for a protracted period of time, SGD will weaken an average of four per cent against the USD during the period of contraction. Hence, we expect SGD to weaken to around 1.30-1.31 in the first quarter of 2012 from 1.2818 on 5 December 2011.

CURRENCIES

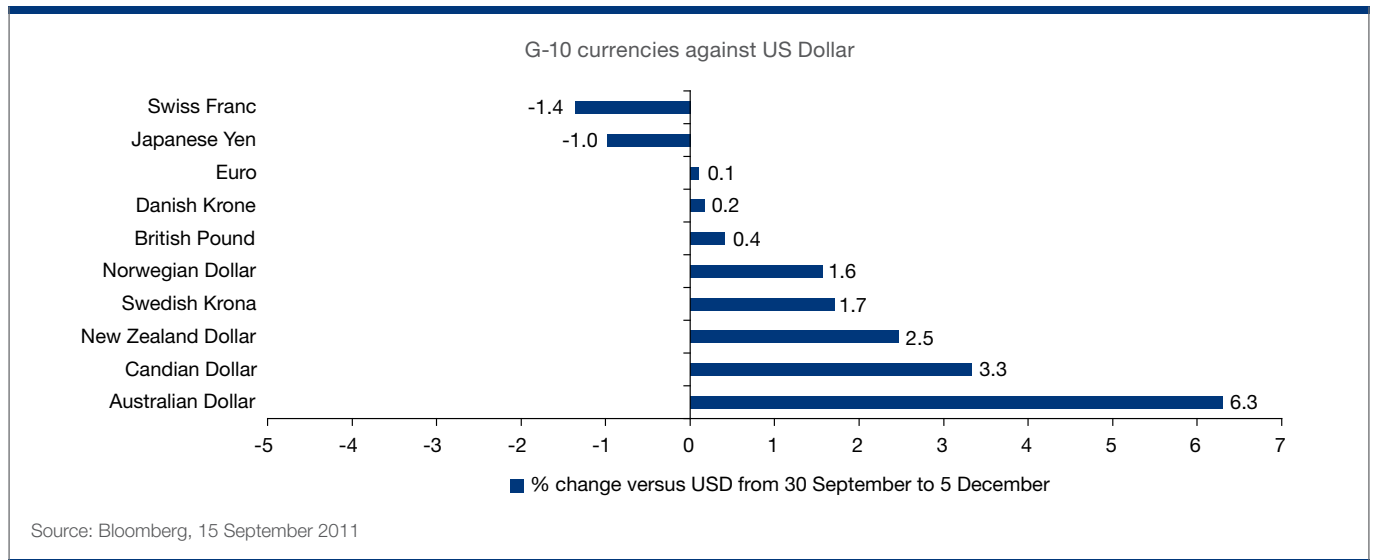


CURRENCIES

Fourth Quarter Review

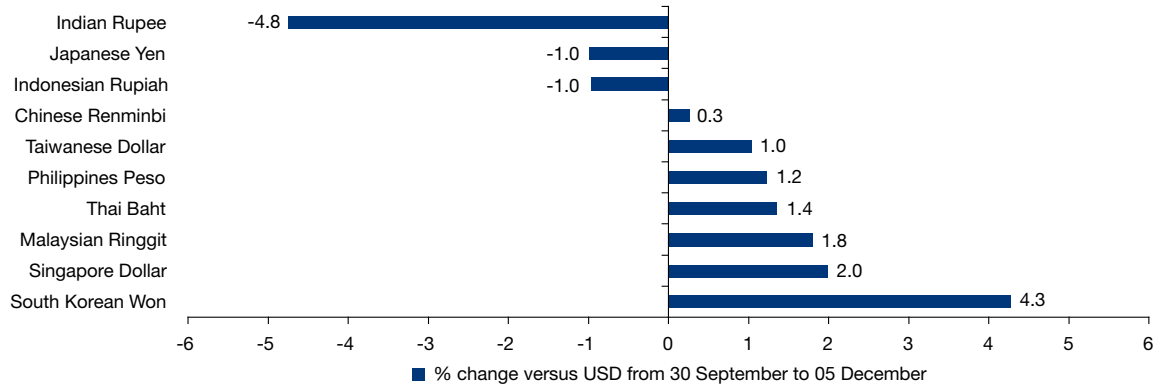
The US dollar (“USD”) performance was broadly stronger the fourth quarter of 2011 due to the market relief over the

unveiling of plans to leverage up the EFSF to US\$ 1 trillion in late October. Only the Japanese Yen and Swiss Franc sold off against the USD in the third quarter. The rest of the G10 FX all rallied, which the AUD (6.3 per cent), Canadian Dollar (3.3 per cent) and New Zealand Dollar (2.5 per cent) were the best performer G10 FX.



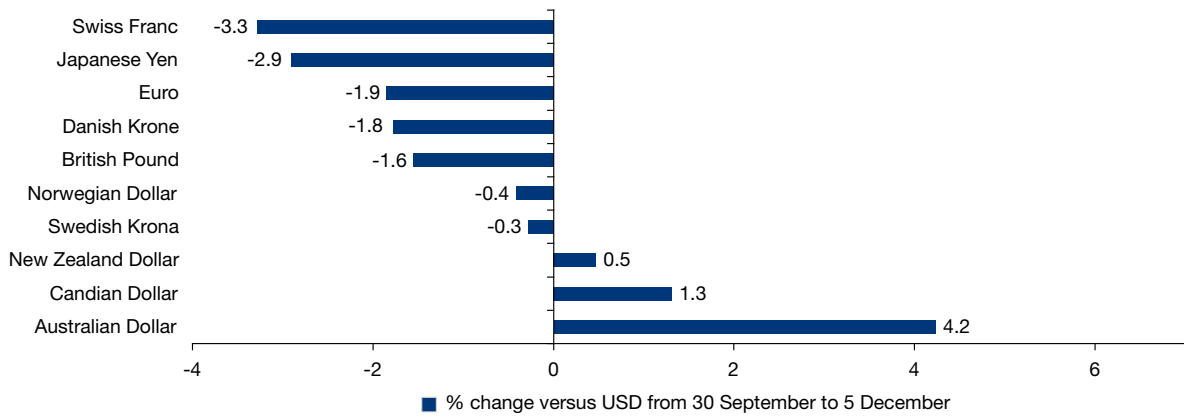
Asian currencies were also broadly stronger against the USD over the final quarter of 2011. Only Indian rupee (-4.8 per cent), Japanese Yen (-1.0 per cent) and Indonesian Rupiah (-1.0%) was weaker against the USD. The best performing Asian FX were Korean won (4.3 per cent), Singapore dollar (2.0 per cent), and Malaysia ringgit (1.8 per cent).

Asia FX versus USD



Source: Bloomberg, 15 September 2011

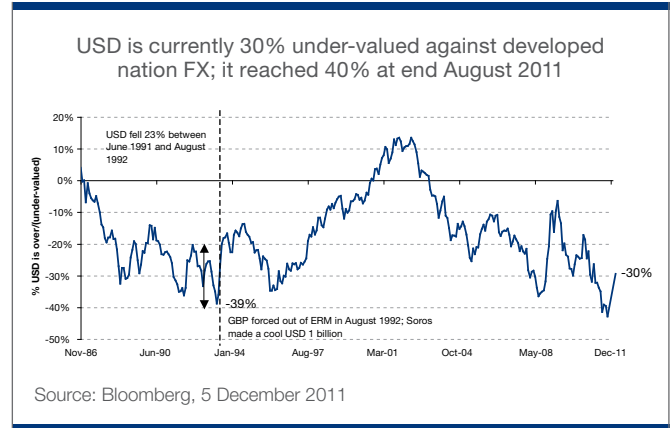
G-10 currencies against Singapore Dollar



Source: Bloomberg, 15 September 2011

Outlook & Strategy

The Asian Dollar Index (ADXY) rose 1.1 per cent in the fourth quarter of 2012 from a fall of 3.5 per cent in the previous month. Our internal model suggests that the USD is around 30 per cent under-valued against the developed nation FX in November. This compares to a 42 per cent under-valuation in August 2011. We think that the upside for the USD could at most gain around five to ten per cent from here onwards, although if the Europe situation deteriorates, the USD could rally a lot more. We remain cautious on the European crisis. We believe that the USD could strengthen further in the first quarter of 2012 as global growth slows further. The EUR looks over-valued at 1.34 on 5 December 2011. We think that it will slowly grind toward 1.20 in 2012.



CURRENCY FORECAST

Currency	Against USD 5 December 2011	Forecast End 1Q 2012
Japanese Yen (JPY)	77.82	77.0
Euro (EUR)	1.3401	1.30
Singapore dollar (SGD)	1.2818	1.3025

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