

QUARTERLY INVESTMENT STRATEGY

Slowdown not double-dip

Third Quarter 2010



BEST ONSHORE FUND HOUSE (SINGAPORE)

Asia Asset Management
THE JOURNAL OF INVESTMENTS & PENSIONS
BEST OF THE BEST AWARDS
BEST RETAIL HOUSE (SINGAPORE) 2009



BEST FUND GROUP (OVERALL)



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CIO MESSAGE

The first half of 2010 has been a roller-coaster period for investors, with equity markets making swings of 15% to 20% over the course of the six months as investors climbed the proverbial 'wall of worry'.

Markets have lacked conviction this year because investors are being pulled in two directions - one secular, the other cyclical. On the secular front, the market has become very sensitive to the large and growing level of government deficits in the developed economies. The crisis over Greece and the other indebted peripheral Eurozone economies is a manifestation of these concerns. However, the problem extends wider and the government deficits in Japan, the UK and the US could potentially become a focus of the market.

Behind the headlines surrounding the European crisis, there has however been the steady improvement of the global economy. The cyclical recovery has turned out to be stronger and faster than expected and the latest data still points to a continued expansion in economic activity. The return to growth is providing a sizeable boost to corporate profits, particularly as companies are enjoying exceptionally high operating leverage in light of the aggressive cost cutting they undertook during the recession.

It has not been easy for investors to weigh the secular concerns against the cyclical recovery. The question of sovereign risk does not fit easily into any conventional risk-reward framework. The €750 billion stabilisation package buys time for Greece and the peripheral economies but does not appear to change the underlying solvency risk. Investors are therefore either standing aside or asking for higher returns.

With investors demanding greater fiscal discipline from governments, the market has also begun to question the sustainability of the global economic recovery. The global economy was put back on its feet by unprecedented fiscal and monetary stimulus from policymakers. The recovery could falter if government spending is reined in while households in the developed economies are still deleveraging.

Whether the recovery is self-sustaining or not depends largely on the US labour market. If the US is back to creating jobs, US consumers will continue to spend, even if modestly. Then companies will continue hiring, rebuilding inventories and expanding capacity. So far, the signs we have seen are modestly encouraging. The private sector in the US has been

creating jobs since January this year, albeit at a slower pace than what the market was anticipating.

One important reason why we think we can avoid a double-dip recession is because the global business cycle today is at a different stage compared to 2008. The corporate sector has not rebuilt its inventories and hiring has been cautious and even if the European crisis begins to affect business confidence, it would be difficult to envisage a repeat of the extraordinary retrenchment we saw in the wake of the Lehman crisis.

If, as we believe, we are not about to fall into another recession, then equity markets are attractively priced. Because markets have been volatile, analysts have been cautious in revising their earnings estimates and equity multiples have compressed. The forward PE of the S&P 500 at 12.2x is close to the level where it was at the beginning of 2009, just before the market began its rally. This is similarly the case for MSCI Asia ex Japan, which is trading around 10.9x.

For Asian equity markets, an added headwind has been the policy tightening in China. The determination of the Chinese authorities to cool the property market has led to greater fears of a hard landing of China's economy. Property prices in China have finally begun to decline. If there are more convincing signs that prices are under control and inflation is not a problem, policy tightening in China is likely to ease. This would be a relief to Asian equity markets.

The one asset class which has clearly benefited from the uncertainty and volatility this year is gold. The price of gold in every major currency is at record high. Compared to equities and bonds, gold only makes up a tiny percentage of global portfolios and the small shift that has been occurring in asset allocations is the key reason why gold prices have risen. We have been advocating that investors consider some exposure to gold and gold equities to diversify their risk and this is something which we believe is worthy of consideration.

To sum up our view, while we expect markets to continue on its choppy course, we do not expect the global economy to enter another recession. We believe that the current phase of volatility is a bull market correction and not the start of a bear market. Therefore, we stay positive on equities.

Thio Boon Kiat, *Group Chief Investment Officer*



SUMMARY

Continued uncertainty over Europe's debt crisis and policy tightening in China is likely to keep equity markets volatile.

More policy initiatives from European policymakers to assuage default fears and signs that funding stress in interbank markets is abating would help calm markets. For China, a signal that the government has seen sufficient evidence of property prices coming under control and that its policy tightening is over would be welcomed.

The recovery of the global economy and corporate profits so far remains intact.

Although the continued volatility in financial markets raises the risk that business and consumer confidence will be affected, our view is that we are likely to avoid a double-dip recession. This is because the global economy is at a very different stage of the business cycle compared to 2008. Companies have not been hiring aggressively and inventories have not been rebuilt. The kind of retrenchment we saw after the Lehman episode is therefore unlikely to be repeated.

Central banks are likely to keep interest rates low for a while, and this should continue to support risk assets.

The crisis in Europe is keeping central banks dovish and we do not expect to see interest rate hikes by the major central banks this year. Interest rates at more or less zero percent are likely to attract funds back into risk assets.

As we do not expect another recession, we believe the market is only experiencing a bull market correction rather than the start of a fresh bear market. We retain our overweight in Equities and the underweight in Bonds. We also stay overweight in Commodities.

Within Equities, we stay overweight in the US, Asia and Latin America, and remain underweight in Europe and Japan. For Fixed Income, we continue to prefer Investment Grade bonds. In Commodities, we are overweight in Gold and Base Metals.



Source: Bloomberg, 15 June 2010

INVESTMENT OUTLOOK AND ASSET ALLOCATION



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Equity markets continued to be marked by volatility in the second quarter of 2010. Investors remain troubled by the debt problems in Europe and fears of a hard landing in China have grown stronger. However, the rise of risk aversion in financial markets has not appeared to have spilled over to the real economy. Global economic indicators continue to show signs of recovery. The key question is whether a negative feedback loop develops whereby continued volatility in financial markets affects business and consumer confidence. We discuss these issues below.

1. Eurozone debt crisis – liquidity or solvency issue?

The main reason for the ongoing volatility in equity markets has been the sovereign debt crisis in the Eurozone. The crisis was initially centred on Greece but contagion developed and the government bond yields of the other larger, highly debted peripheral Eurozone economies - Portugal, Italy, Ireland and Spain – have also risen. The rise in bond yields means that the borrowing cost of these economies have become higher, making it more difficult for them to repay their debts.

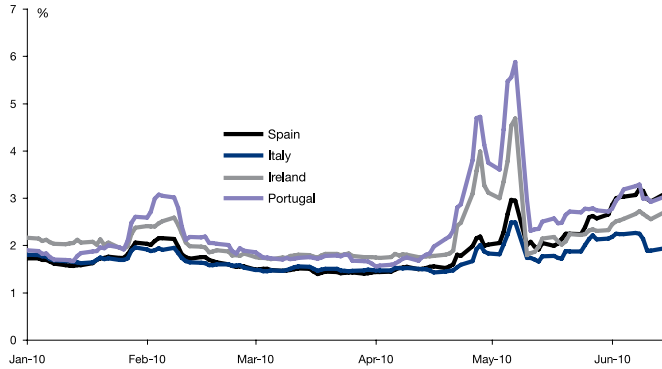
The EUR110 billion adjustment programme for Greece and the EUR750 billion stabilisation programme announced by the European policymakers calmed markets for a short period but investors continue to be dogged by underlying worries. To the market, Greece appears to be facing a solvency issue but the policymakers appear to be treating it as a liquidity problem. The rescue package will allow Greece to roll over its debt in the next few years but many believe that ultimately, Greece will not be able to meet its debt repayment obligations. Many regard the austerity programme laid out for Greece as overly ambitious. The programme requires massive cuts in government spending, the ability to raise tax revenue and a return to positive growth within a few years.

As a reflection of investors' scepticism and a sign that contagion is still a problem, buyers have not returned to the Eurozone government bond markets and the bond yields of Italy and Spain have risen to levels higher than what they were before the stabilisation programme was announced. As part of the stabilisation package, the European Central Bank (ECB) has been buying Eurozone government bonds, but the ECB has bought almost only Greek, Portuguese and Irish bonds, and not Spanish or Italian bonds.



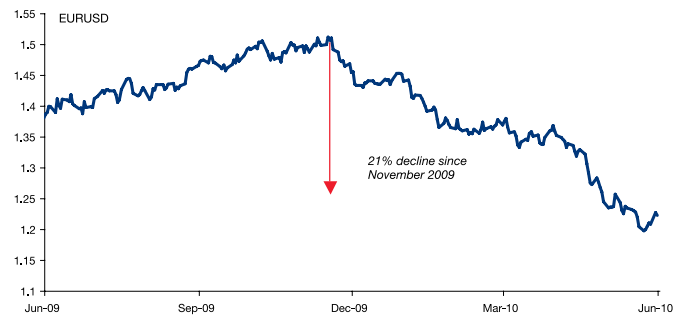
INVESTMENT OUTLOOK AND ASSET ALLOCATION

Two-Year Government Bond Yields



Source: Bloomberg, 15 June 2010

Euro against the US dollar



Source: Bloomberg, 15 June 2010

One consequence of the ECB's purchase of government bonds is the continued decline of the euro. Unlike the US Federal Reserve, which has a mandate over both inflation and growth, the ECB only has an inflation mandate. With its purchase of government bonds, the line between monetary and fiscal policy is now blurred. The decline of the euro has meant a concomitant strength of the US dollar. All other things being equal, a strengthening US dollar usually creates a headwind for equity markets, especially Emerging Markets.

The European policymakers have also roiled the market by their abrupt changes in market regulations. In May 2010, Germany announced an overnight ban on short selling which stunned markets and contributed to an increase in volatility. The adoption of increasingly populist policies towards the financial sector is ironically making it tougher for the highly indebted governments to fund themselves as uncertainty keeps market participants on the sidelines.

The overall environment of risk aversion and uncertainty has also led to funding stress in the European interbank market. The difference between interest rates charged for secured and unsecured lending has been drifting upwards. This indicates that banks are once again becoming more cautious in their lending. The freezing of the interbank lending market was a major feature of the credit crisis in 2008.



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Three-month US dollar Libor-OIS spread



Source: Bloomberg, 15 June 2010

Note: The spread between the London Interbank Offered Rate (Libor) and the Overnight Index Swap (OIS) measures the "fear" of counterparty failure by banks.

The biggest risk of another banking crisis lies in Spain. Spain experienced a property bubble in the early and mid 2000s and during that period, Spanish savings banks expanded their loan books aggressively. These savings banks, or the *cajas*, account for 44%¹ of the loan market in Spain. The *cajas* depended on funding in the wholesale market as loans were growing faster than deposits. But the *cajas* are not commercial banks and most of their recent debt issuance have carried government guarantees. A banking crisis in Spain may therefore evolve to become a sovereign crisis.

2. China's tightening measures have been more aggressive than expected

Another headwind for equity markets is the tightening measures undertaken by the Chinese authorities to cool the property market. Since the beginning of this year, the reserve requirement ratio has been raised three times and a series of administrative measures were implemented to curb speculation and bring down property prices. The minimum down payment for loans on second homes was increased from 40% to 50% and the mortgage rate for second homes was increased from a 15% to 30% discount to the benchmark rate to 1.1x the benchmark rate. In selected cities, banks are not allowed to extend mortgages for third homes.

¹ Source: Morgan Stanley, Spain Economics, 12 April 2010

² Source: JP Morgan, Hands – On China Report, 3 June 2010

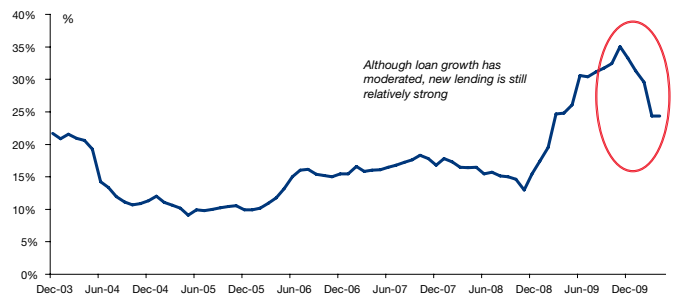
³ Source: JP Morgan, Hands – On China Report, 3 June 2010

⁴ Source: JP Morgan, Hands – On China Report, 3 June 2010

⁵ Source: Deutsche Bank, Asia Economics Monthly, 18 May 2010

The government has also forced banks to slow their credit growth. Loan growth peaked at 34.8%² on a year-on-year basis in November 2009 and had moderated to 24.1% in April 2010. The government's target for broader money supply growth has been set at 17% for all of 2010. The money supply grew at 23.9%³ in the first quarter of 2010 and monetary growth has to slow considerably for the rest of the year to meet the full year target for 2010.

China Loan Growth



Source: JP Morgan, Hands-On China Report, 3 June 2010

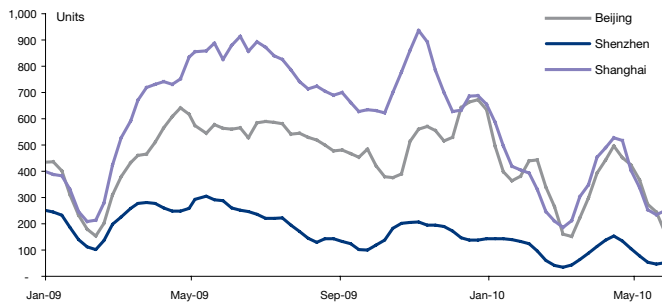
The Chinese authorities is also attempting to manage the pace of lending. In 2009, the bulk of new loans was front-loaded in the first half of the year. Not all the funds were deployed to the real economy and a significant portion most likely found its way into the asset markets. The regulator have instructed the banks to issue new loans in the proportion of 3-3-2-2 over the four quarters of 2010.

These cooling measures have been characterised as the most aggressive since the 1990s and the impact was finally seen in May 2010 when property transactions plunged 51%⁴ from April 2010. The average selling price also dropped by about 10%⁵ from the April peak.



INVESTMENT OUTLOOK AND ASSET ALLOCATION

China Property Transactions
(Average Daily Sales Volume, one-month moving average)



Source: JP Morgan, Hands-On China Report, 3 June 2010

Investors are concerned about how much the slowdown will impact the property sector as well as the broader economy. The drop in transaction volumes will affect the financial position of property developers and slow the growth in the construction sector. Prices for raw materials will fall as demand slows. Falling property prices can also affect the asset quality of Chinese banks.

Another concern is the return of inflation and the potential for hikes in official interest rates. China's consumer price inflation rose to 2.8% in April 2010. It is usually thought that the Chinese authorities have a 3% threshold and beyond this, there is an increased likelihood of interest rates being raised. The debt crisis in Europe is likely to stay the hand of the People's Bank of China and interest rates hikes could be delayed.

3. Global economy continues to recover but pace is moderating

The risk aversion in the financial markets has so far not materially affected the real economy. Global economic indicators have all continued to point to the further expansion of economic activity. We are however past the strongest phase of growth and the pace has moderated.

The key leading indicator, the US Institute for Supply Management, was 59.7 in the latest May survey. At 59.7 it was down from the 60.4 in April but is still well above the boom-bust line of 50. In the May survey, the employment index was up 1.3 points to 59.8 while the new orders index was flat at 65.7. The equivalent Purchasing Managers' Indices of the other major economies, Europe, Japan and China, have also all pointed to still firm economic expansion, but all surveys have also showed signs of moderation.

Purchasing Managers' Indices

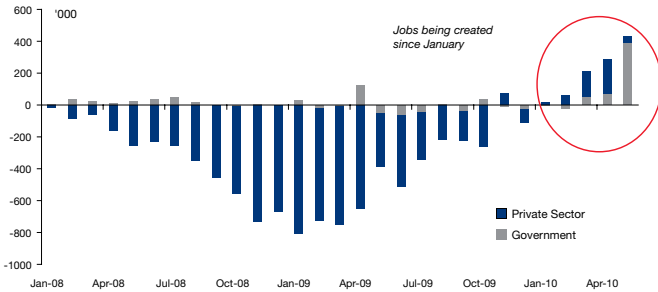


Source: Bloomberg, 15 June 2010

Furthermore, the labour market in the US has entered a period of job creation. Although the non-farm payrolls figures are currently being boosted by temporary employment for the US 2010 Census project, the private sector has also been hiring. Private sector hiring has taken place for five consecutive months since January this year.

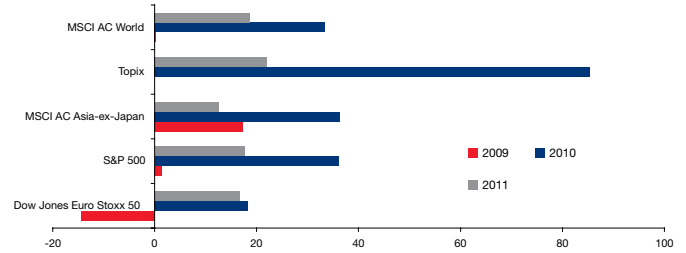
INVESTMENT OUTLOOK AND ASSET ALLOCATION

US Private and Government Nonfarm Payrolls



Source: Bloomberg, 15 June 2010

Consensus Earnings Growth Estimates



* Topix 2008 EPS was negative, resulting in non meaningful 2009 EPS growth comparison.

Source: Datastream, IBES Estimates, 31 May 2010

The pickup of the labour market is important because it significantly increases the chances that the economic recovery is self-sustaining due to the 'multiplier effect'. A stabilisation in the labour market increases consumer confidence, and when consumers spend, corporates rebuild inventories and increase hiring, which further increases consumer confidence and spending, and this process sustains the momentum of the economy.

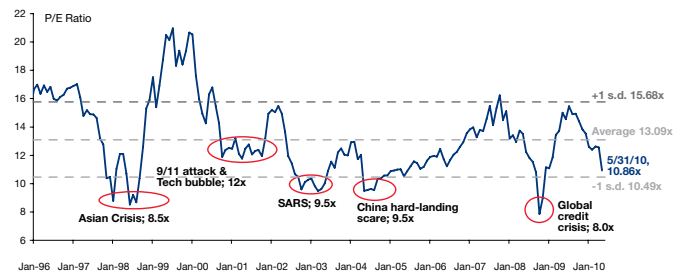
As earnings estimates have been steady, the fluctuations in the equity market have been driven by the expansion and contraction of equity multiples. With the pullback in the second quarter of 2010, multiples have been compressed and MSCI World is currently trading at 11.4x⁷ 12-month forward earnings. MSCI Far East ex Japan is at 10.9x 12-month forward earnings, a level which is close to previous episodes of stress.

4. Corporate profits also continue to recover

The first quarter 2010 US reporting season was another robust one. The better than expected profits came from both higher margins and also higher sales. In the initial months of recovery, profits were being driven by extensive cost cutting, in capital expenditure and hiring. But revenues are now also rising. The cost cutting measures undertaken during the downturn mean that corporates are enjoying very high operating leverage and a modest rise in revenue is translating into a significant boost to profits.

However, because markets have been volatile, analysts have stayed relatively cautious and earnings estimates for the coming quarters are largely unchanged. The consensus expectations for the full year of 2010 is for the S&P 500 earnings to rise by 36%⁶, and for 18% in 2011. Globally, analysts are forecasting 33% earnings growth in 2010 and a further 19% in 2011.

MSCI Far East ex Japan Consensus Forward Price/Earnings Ratio



Source: MSCI, Datastream. IBES Estimates, 31 May 2010

⁶ Source: Datastream, as at 31 May 2010

⁷ Source: Datastream, as at 31 May 2010



INVESTMENT OUTLOOK AND ASSET ALLOCATION

ASSESSMENT

We remain cyclically bullish but tactically cautious. We believe that the current volatility in equity market is a bull market correction rather than the start of a new bear market. Although risks have risen, we remain sanguine that the problems in the Eurozone are unlikely to translate into a broad-based downturn for the global economy and that we are able to avoid a double-dip recession. If, as we believe, the macroeconomy continues to recover, corporate earnings will also continue to recover.

One reason why we believe a double-dip recession is unlikely is because the real economy is in a very different position from 2008. In the wake of the Lehman shock, corporates and households dramatically cut back on their spending and corporates also allowed their inventories to be drawn down. Although the global economy returned to positive growth about a year ago, global inventories have by and large not been rebuilt. Corporates have also been modest in their capital expenditure budgets. The sharp degree of labour retrenchment we saw in 2008 is also unlikely because the private sector has not resumed its hiring in any aggressive manner.

A substantial correction in equity markets in the second year of a cyclical bull market is in fact typical. In most cycles, the initial months of the recovery are usually the most pronounced and equity market returns reflect this. However, the rate of growth inevitably has to slow and equity markets start to discount the moderation in pace, even though the economy is still recovering. The recovery in earnings also moderate and markets also discount this.

To us, the equity markets appear more similar to 2004 than 2008. After the Internet bear market ended, equity markets had a powerful rally in 2003, faltered during the course of 2004 but ended the year in positive territory. The rally then continued till October 2007. Similar to the present, Asian markets in 2004 were also driven by fears of a hard landing in China and witnessed a greater correction than the US.

2004 Correction of MSCI Asia ex Japan



Source: Bloomberg, 15 June 2010

The investment environment is however not exactly similar to 2004 as the cyclical picture is being complicated by structural problems, i.e. the fiscal problems in developed economies. As there are more uncertainties, the volatility in markets could last longer than normal.

Investors are likely to stay edgy until the fears of a sovereign default in Europe are assuaged. More initiatives by the European policymakers and signs that funding stress in the interbank market is abating would help calm investors.

For China, it is likely that the government will continue to stay tough on the property market in the near term. The Chinese government has never reversed a policy within three months of a major change. A signal that property prices are under control and that policy tightening is over would be welcomed by the market.

The market will also be focused on economic data in the coming months to gauge if the recovery is sustainable or if there has been a spill-over from the debt crisis in Europe. Resilient data is likely to stabilise equity markets.



INVESTMENT OUTLOOK AND ASSET ALLOCATION

ASSET ALLOCATION

	Conservative	Change from 2Q 2010	Moderate	Change from 2Q 2010	Growth	Change from 2Q 2010
Equities <i>Remaining Overweight</i>	50%	0%	60%	0%	80%	0%
Bonds <i>Remaining Underweight</i>	40%	0%	30%	0%	10%	0%
Commodities <i>Remaining Overweight</i>	2.5%	0%	7.5%	0%	7.5%	0%
Cash instruments <i>Remaining Underweight</i>	7.5%	0%	2.5%	0%	2.5%	0%

Note: The neutral Moderate benchmark weights are Equities (55%), Bonds (35%), Commodities (5%) and Cash (5%).



INVESTMENT OUTLOOK AND ASSET ALLOCATION

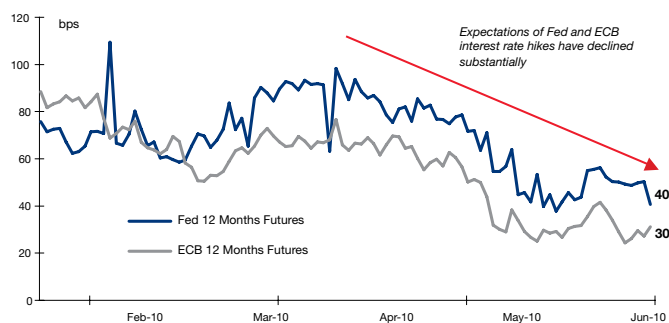
Retain overweight position in Equities

We had underestimated the reaction of equity markets to the debt problems in the Eurozone but continue to believe that the strength of the recovery in the US will drive asset markets for the coming months. We therefore keep our overweight position in Equities.

Apart from the recovery in the global economy and the improvement in corporate profits, equity markets are also supported by the liquidity environment. The debt crisis in the Eurozone is likely to have pushed back the schedule of interest rate hikes by the key central banks, in particular the US Federal Reserve and the ECB. At the beginning of 2010, the interest rate futures market was pricing about a 100bp hike by the Fed over the coming 12 months. This has fallen to only 40bps⁸.

Interest rates at close to zero is very supportive of risk assets. For a start, the dividend yield of global equity markets is currently 2.8%⁹ and payouts are likely to be lifted in 2010 and 2011, restoring dividends which were slashed in 2009.

Futures market pricing of Fed and ECB policy rate hikes over next 12 months



Source: Bloomberg, 15 June 2010

⁸ Source: Bloomberg, as at 15 June 2010

⁹ Source: UBS Global Equity Strategy, 25 May 2010



INVESTMENT OUTLOOK AND ASSET ALLOCATION

We make no changes to our allocations for the various equity markets. We stay overweight in the US, Asia and Latin America. We have underweight positions in Europe and Japan and we are slightly underweight in Canada and Australia.

The **US** economy has bottomed and there are signs that the industrial recovery is broadening out. The housing market appears to have stabilised and the job market is improving. Having moved aggressively to manage costs during the downturn, the US corporate sector is poised to benefit from the gradual recovery in final demand. The US appears to be the first-in/first-out (FIFO) of the Developed Markets. Relative valuations versus growth prompt us to stay overweight.

Europe's financial conditions have deteriorated and fiscal headwinds may constrain growth. Consensus estimates for Eurozone growth continue to be reduced. Despite the fact that European valuations are amongst the cheapest in the world, structural concerns lead us to stay underweight.

For **Japan**, while corporate profits are projected to rebound sharply in the current year and next, core operating performance leaves much to be desired. The recent strength in the yen has weighed on exporters. Corporate profitability needs further recovery before we can justify further capital allocation. We are slightly underweight in Japan.

We are still overweight in **Asia ex Japan** but adopt a more defensive stance, focused on domestic consumption. China's moves to tighten monetary conditions to address an overheating property market and the reversal of some of its prior stimulus have raised concerns. Strong upward wage adjustments raise questions about corporate earnings and also contribute to inflation concerns.

Latin America continues to represent an attractive investment opportunity, underpinned by strong domestic growth. While there are some near term risks due to higher inflation, the central banks, most notably Brazil, are generally ahead of the curve in fighting inflation. The region continues to offer strong long term investment opportunities for equity investors. We remain overweight in Latin America.

Asset Allocation	3Q 2010 Recommendation	Benchmark
Equities	60%	55%
US	45.0%	41.5%
Europe	24.3%	28.2%
Asia ex-Japan	10.6%	8.7%
Japan	7.4%	8.9%
Australia	2.9%	3.5%
Canada	3.8%	4.0%
Latin America	6.0%	2.9%
Others	0.0%	2.3%



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Retain underweight position in Bonds

Developed Markets

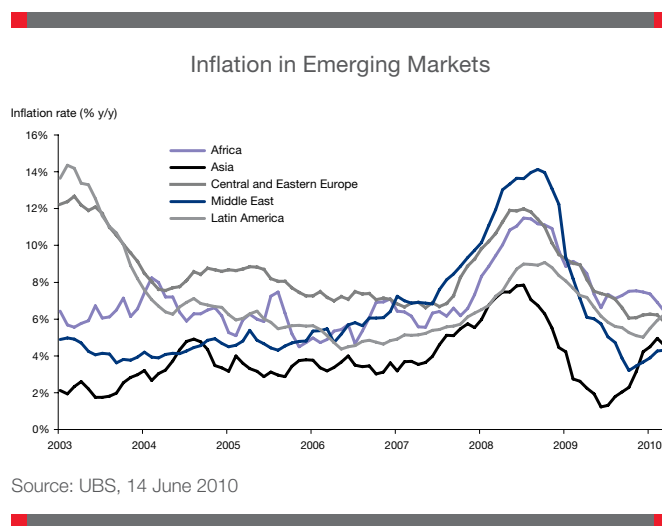
Governments Bonds enjoyed a rally in the second quarter of 2010 as risk aversion rose further and there was a greater flight to safety. Although the bond yields in the peripheral Eurozone economies moved up sharply, this was more than offset by the rally in US Treasuries and German Bunds. UK gilts also rallied as the new coalition government has been vocal about reducing public sector debt. We maintain our underweight position in Government Bonds as we do not expect a double-dip recession scenario and we believe bond yields will rise once risk aversion abates. Over the medium term, the strong headwind for government bonds is the large supply forthcoming as government deficits remain sizeable. Fiscal sustainability is clearly an issue with investors and there is a new premium on sovereign risk. We are overweight in the core Eurozone markets, and neutral in the US and the UK. We are underweight in Japan. We are long duration in the core European markets, neutral in the US and short duration in the UK.

We maintain our overweight in **Investment Grade** bonds. From a credit fundamental and valuation view point, Investment Grade bonds have become more attractive following the sell-off in May 2010. Fundamentals continue to improve, with the recovery in earnings being an impressive one, balance sheets being repaired and interest coverage ratios rising. We prefer US to European names which are directly exposed to the macroeconomic problems in Europe. Sectors we like are Utilities, with their stable cash flows and strong credit profiles; Capital Goods, where cost cutting has been aggressive; Basic Materials and Energy, where balance sheets have been deleveraged via asset disposals and reduced capital spending; and the Insurance Sub-sectors where capital levels have improved and US Managed Care companies which are able to absorb the cost impact of the US healthcare reforms.

We have reduced our position in **High Yield** corporate bonds to an underweight due to the rise in risk aversion. High Yield, with their weaker credit profile and higher beta is more sensitive to macroeconomic and market risks. This is reflected in the underperformance of High Yield which posted negative return of -4.96% compared with -3.34% for High Grade during the recent sell-off. We avoid sectors that are more vulnerable to regulatory, credit and M&A risks such as Financials, Media, Building Materials and Consumer Cyclical.

Emerging Markets

We prefer Emerging Markets (EM) to the Developed Markets. Growth in EM will continue to outpace the Developed Markets but inflation risks appear contained as EM central banks are acting pre-emptively. Public debt levels in EM also remain low and this provides EM governments with fiscal flexibility. External debt levels in EM have also been on a down trend. Although the overall outlook is positive, investors' appetite in the near term is likely to be dictated by events in Europe. Within Emerging Markets, we stay overweight in Asia and Central/Eastern Europe and are underweight in Latin America and the Middle East.



INVESTMENT OUTLOOK AND ASSET ALLOCATION

In the **Asia Fixed Income** market, we prefer High Grade to High Yield. Sentiment towards the Asian credit market is likely to remain weak over the next three months as more evidence emerges to indicate that China's economic growth is decelerating. With a flattening of the US government yield curve, Asian high grade corporate bonds also offer an ideal place for global funds to park investments. We prefer the Singapore and Hong Kong High Grade names as these two countries are viewed as safe havens. We are underweight in the Chinese property sector as it may continue to underperform due to policy risks.

Given the rise in risk aversion, we have now turned bullish on the long-end **Singapore Government Securities** (SGS). In particular, we like SGS 3.25% 2020 as its current yield of 2.65% is 20 bps to 25 bps higher than its fair value yield. On the **Singapore Corporate** front we like AAA-rated **Areit** 1.6% 01/2017 (putable at par in 2015), which is currently yielding 3.0% or 215 bps higher than the five-year SGS.

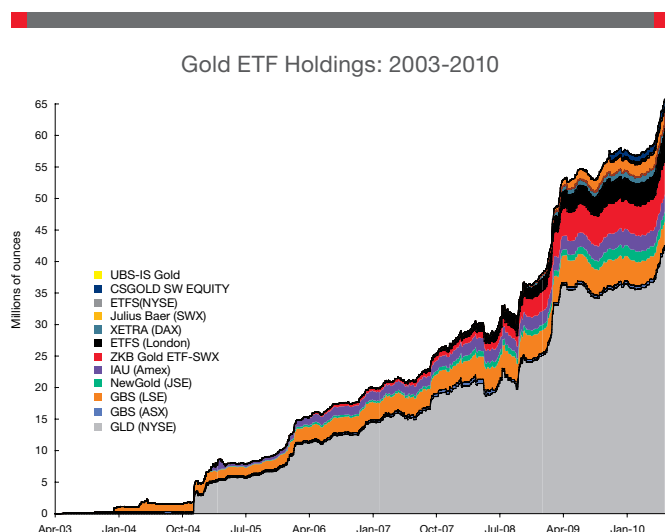
Asset Allocation	3Q 2010 Recommendation	Benchmark
Fixed Income	30%	35%
Developed	40%	70%
Government	51%	71%
Investment grade	42.0%	21%
High yield	7.0%	8%
Emerging	60%	30%
Asia	33%	30%
Latin America	29%	33%
Central/ Eastern Europe	30%	27%
Middle East/Africa	8%	10%



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Retain overweight position in Commodities

We hold our overweight position in **Gold**. The price of gold rose to a record high in June 2010 not only in US dollars but also in euro, sterling pound and Swiss francs. Gold is a major beneficiary of the sovereign debt crisis in Europe and the wider concern about growing government deficits in the developed economies. One key driver of the gold price has been flows into gold Exchange Traded Funds (ETFs). The holdings of SPDR, the world's largest gold ETF, rose to 1,268 tonnes¹⁰ in June 2010. The ETF now holds a larger volume of gold than all but five central banks.



Source: UBS, 14 June 2010

Note: Legend lists the ETFs by their 'ticker' identification codes on their respective stock exchanges. For example, GLD refers to the SPDR ETF listed on the New York Stock Exchange.

India have also been expanding refining capacity. The ongoing worries about Europe and the potential downturn of the global economy are also likely to keep oil prices contained.

We retain our overweight in **Base Metals**. Base Metals sold off strongly in the second quarter of 2010 but the strength of global manufacturing remains fundamentally positive for base metals. China's economy continues to be firm and we believe the authorities are easing their policy tightening given the ongoing problems in the Eurozone. Copper inventories in the London and Shanghai exchanges have also been declining.

We also retain our underweight position in **Agriculture**. Grain prices remain under pressure as weather conditions have been good and the latest report on US crop plantings indicate a high percentage of crops being in good/excellent conditions. The pace of US planting has also accelerated - US corn planting is complete, US soybean planting is 84% complete and US cotton planting is 91% complete.

Asset Allocation	3Q 2010 Recommendation	Benchmark
Commodities	7.5%	5%
Gold	30%	25%
Base Metals	25%	20%
Agriculture	15%	20%
Energy	30%	35%

We retain our underweight position in **Energy**. We are into the US summer driving season and the oil market traditionally looks at the strength of US demand at this time of the year. The rise in US gasoline demand should be positive but modest given that US consumers are still cautious. In recent years, gasoline demand from Asia, Latin America and the Middle East have also been important in driving oil prices and this demand has remained robust. Demand is however unlikely to drive prices in the near term as there is surplus refining capacity in the developed economies. China and

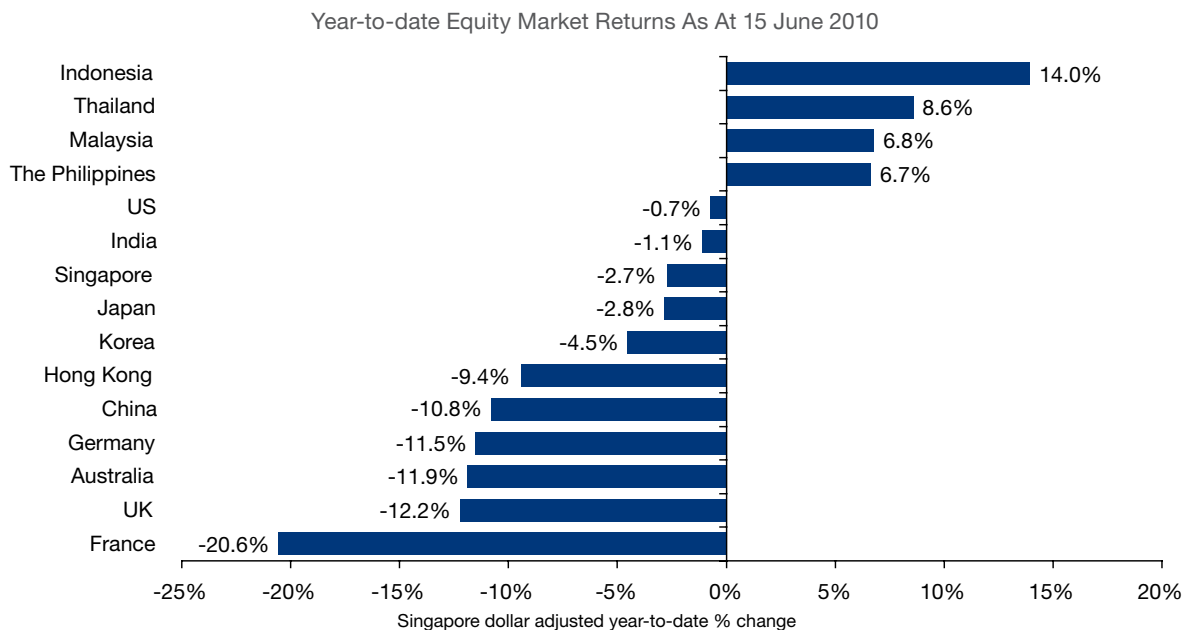
¹⁰ Source: Deutsche Bank, Commodities Weekly, 4 June 2010



GLOBAL EQUITY STRATEGY



Market Returns



Source: Bloomberg, 15 June 2010

US

Equity Strategy

One of the key changes is to move Consumer Discretionary to an underweight position, in favour of Consumer Staples. Other than that, we target to reign in our previous overweight and underweight positions, given poor visibility on the corporate outlook at this stage. We expect the S&P 500 to trade over a wide range over the next quarter or two, as corporates and analysts fine tune their forecasts. We are not adopting a fully defensive strategy as the May 2010 market sell-off has presented mispriced opportunities.

Within the **Consumer** space, we have brought Consumer Discretionary weights down to an underweight position, in favour of the Consumer Staples sector. The **Consumer Discretionary** sector sees many headwinds going into the second half of 2010. While the cyclical economic rebound in the early 2010 is supporting personal consumption expenditures (PCE), real disposable income growth remains weak, questioning the sustainability of personal spending. For example, while April's PCE was up 2.2%, personal disposable income rose only 1.3%. Even more notable is, excluding current transfer receipts (such as unemployment benefits), personal disposable income would have fallen by 1.1%. In addition, the sector historically underperforms six months after an unemployment peak. Assuming unemployment peaked in October last year, this would be an appropriate time to reduce our exposure to this sector. Finally, this sector faces tougher comparisons compared to 2009 and earnings would also be impacted by a weaker euro.



GLOBAL EQUITY STRATEGY

We raised our exposure to the **Consumer Staples** sector as it has defensive growth companies that are able to deliver consistent and quantifiable earnings and that possess balance sheet strength. This sector typically outperforms during periods of declining economic growth and high volatility. Among Consumer Staples, we like companies in Beverages, Food, and Household Products. Our preferred stocks are **Proctor and Gamble** and **Pepsico**.

Structurally, we still like **Technology** and **Industrials** for their many positive longer term drivers, even after accounting for lowered growth expectations. Hence, while their sectors are cyclical in nature, we are still at neutral weight in these sectors.

Many **Technology** companies are experiencing record sales and margins. Coupled with high productivity levels and the current environment of a low-cost capital, this sector is poised to experience sustained growth for the next several years, though at a slower pace. Within IT, Cloud computing, Storage, Networking and general corporate PC refresh continue to be key growth themes. In this sector, companies we favour include **Dell**, **NetApps** and **IBM**.

In **Industrials**, we still see sequential expansion in new orders coupled with flat inventories. Empirically, this supports continued firm industrial production trends over the following three to four months. Capacity utilisation levels of about 70% is well below trend levels suggesting further upside potential. We believe that the initial, sharp recovery phase of the industrial cycle is coming to a close, and we will likely see a moderation in business surveys and industrial production growth rates in the near future. In the second phase of the cycle, the Electrical Equipment and Machinery sub-sectors tend to perform well in both absolute terms and versus the broader index. These segments have exposure to a more stable consumer consumption in developed economies and exposure to strong consumption in emerging market. We also like companies that command a technological edge over competition in the emerging markets like China. Overall, we anticipate a favourable outlook for Aerospace Engines, Factory Automation, Climate Control, Critical Power, Machine Tools and Energy Efficiency. Companies we favour include **General Electric**, **Emerson** and **Sandvick**.



GLOBAL EQUITY STRATEGY

Key additions to the Model Portfolio

In the Consumer Staples space, we have added **Costco Wholesale Corporation** which operates membership based warehouse clubs mainly in North and South America. It leads in warehouse clubs from a merchandising, store execution and private label standpoint. Costco's accelerated customer traffic growth and uptick in membership renewal rates should continue for several years given the ongoing rise in the perceived value of shopping at warehouse clubs in a sustained weak consumer environment. Outside the US, strong growth prospects and an outlook for continued same-store sales growth supports Costco's premium valuation. Last quarter, same store sales were at 10%, with international sales rising 26%, while renewal rates were at 87.5%.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Underweight	Walt Disney, McDonalds
Consumer Staples	Overweight	PepsiCo, Proctor & Gamble
Energy	Neutral	Occidental Petroleum
Financials	Neutral	Visa
Healthcare	Overweight	Teva Pharmaceuticals, AmerisourceBergen
Industrials	Neutral	General Electric
Information Technology	Neutral	Dell, NetApp Inc
Materials	Slight Overweight	Newmont Mining
Telecom Services	Neutral	Comcast
Utilities	Underweight	-



EUROPE

Equity Strategy

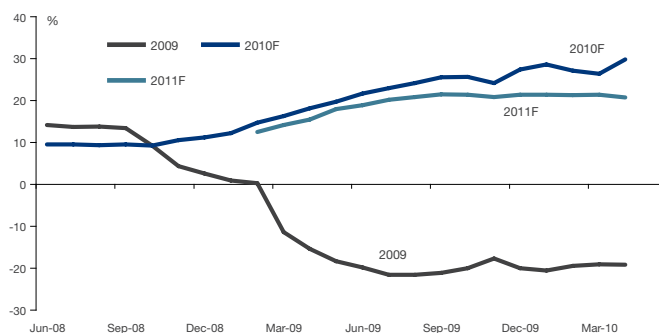
Sovereign risk in Europe remains the focal point. Despite the establishment of the €750 billion European Financial Stability Facility the market remains very nervous. Developments in Europe at the macro-level have occurred against a backdrop of very strong bottom-up corporate earnings. The first quarter of 2010 represented the best earnings reporting season in Europe in five years with a net 17% of companies beating revenue estimates.

MSCI Europe is now attractively valued by almost all valuation criteria. Earnings yield, for example, is well above the 10-year bond yield thus supporting the relative attractiveness of European equities. The market is also trading at a prospective Price/Earnings ratio of 10.4x which is below its mid-cycle multiple of 13.3x and the 38-year average of 17.5x. Similarly, our Price/Earnings Model suggests that the market is 17% undervalued while our Dividend Discount Model, which conservatively assumes a risk free rate of 5% and equity risk premium of 6%, indicates a 21% upside to the European market. This is based on assumptions of earnings growth of 19% for both 2010 and 2011, levels below what the consensus is currently expecting.

In view of the headwinds, we have adopted a slightly more defensive posture. We also believe that the volatile environment will provide us with ample opportunities to buy into well-managed and world class companies that usually trade at a premium to the market in terms of valuations. One such company is **Kuehne + Nagel International AG** which is the global leading player in providing integrated logistic solutions worldwide. Another example is **Reinshaw**, a British capital goods company that thrives on innovative and patented products which include robotics to aid brain surgery.

Overall, we have trimmed our overweight positions in Consumer Discretionary, Materials and Industrial to neutral. This move is also partly on valuation grounds as these sectors have performed well over the past months. The ongoing financial deleveraging in the European financial sectors, further complicated by the European debt problems, has prompted us to increase our underweight position in Financials. We continue to rate both Utilities and Telecoms as neutral, given their relatively higher debt levels. In this environment, we focus on companies with: strong balance sheet positions, focused management with proven track records and a global product offering. In particular, our preference is for companies that can benefit from the unprecedented weakness in the euro. According to the Organisation for Economic Co-operation and Development, a 10% euro depreciation adds around 2% to the Eurozone's nominal GDP growth over two years. It has been estimated that this translates into roughly 3% higher Earnings Before Interest and Tax on average.

MSCI Europe Earnings Growth Consensus Forecast



Source: Datastream, 11 June 2010



GLOBAL EQUITY STRATEGY

Key additions to the Model Portfolio

We have initiated a position in Belgium's **Anheuser-Busch InBev**. AB InBev is the largest brewer in the world following InBev's purchase of Anheuser Busch in 2008. AB InBev has operations in 30 countries and holds then top two positions in 20 of these markets. In addition, the company has the top two positions in the top six global beer profit pools which include the US, Brazil, Russia, Canada, Mexico and Germany. The company owns nearly 300 brands in total. Its main brands are Budweiser, Beck's, Stella Artois, and Brahma. AB InBev has been delivering impressive margin expansion through a strong focus on cost control after the AmBev deal. Following the Anheuser-Busch acquisition, AB InBev is using its experience to take out costs and pay down debt, and this has been driving a double-digit growth in earnings.

We have also added **L'Oréal**, a world leader in cosmetics. The company markets products for skin care, body care, hair care and perfumes globally under various brands including L'Oréal, Lancome, Garnier, Maybelline, Vichy and Giorgio Armani. We expect L'Oréal to perform well in the global large market capitalisation consumer sector due to its innovative product range, outperformance in the global cosmetics market and double digit organic growth in Emerging Markets.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Staples	Overweight	Nestlé
Consumer Discretionary	Neutral	Volkswagen
Energy	Neutral	Tullow Oil
Financials	Underweight	BBVA
Healthcare	Neutral	Sonova
Industrials	Neutral	SKF
Information Technology	Overweight	Autonomy
Materials	Neutral	BHP Billiton
Telecom Services	Underweight	KPN
Utilities	Underweight	EDF



JAPAN

Equity Strategy

Japan's economic indicators remain on the upward trend, led by a recovery in exports, and a boost in consumption from government incentives. In the upcoming quarters, Japan's pace of economic expansion could slow down as industrial production and export growth normalise. The impact of the debt crisis in Europe, the weaker EURJPY rate, and moderation in China's growth may also begin to be felt. This could cause a possible downward revision in corporate earnings. At this point, barring a global economic shock, we think a reduction in earnings forecasts may be minimal.

At the mid-June 2010 TOPIX level of 866.4, the Japan equity market trades at a Price/Book of only 1.05x compared to the historical mean of 1.8x. Prospective Price/Earnings of 16.7x is also lower than the historical average of 18x. This suggests that significant negatives surrounding the problems in Europe are already reflected in stock prices.

We maintain our preference for the cyclical sectors as the recent sharp sell-off has resulted in valuations looking compelling relative to the defensive sectors. However, given that external risks have risen, we are selective, favouring companies with strong pricing power, structural growth drivers and minimal exposure to the euro. We are overweight in Industrials, Materials, Technology, and Energy. We are neutral in Banks, Consumer Discretionary, Consumer Staples, and Real Estate, and underweight in Info-Communications, Pharmaceuticals, Utilities, and Non-Banks.

Key additions to the Model Portfolio

We made minor changes to our model portfolio during the quarter. We added **Shinko Electric**, **Nikkiso**, and **Furukawa Electric**, and removed Nissha Printing, and Tokuyama.

Shinko Electric is the world's second largest flip chip package company, commanding 12% of the global flip chip substrate capacity. It has a 35% share of Intel's central processing unit substrate business. Intel's transition to its new Westmere platform is likely to lead to a supply crunch in flip chips in the second half of 2010. The new platform, with more layers and larger chips, will consume 34% more substrate area for each PC shipped. Another driver of flip chips is the increasing adoption of baseband chips in smart phones. Shinko's flip

chip package operating margin is set to widen from 7.3% in FY2009 to 15% in FY2010 on the increase in the average selling price and changes in product mix.

Nikkiso commands a 50% share of the dialysis equipment market in Japan, and has a 15% to 20% market share in China. Its 49% stake in a joint venture with Weigao (a local Chinese medical supplier) will enhance its access to the dialysis equipment market in China. In industrial equipment, Nikkiso is one of three companies in the world that make cryogenic pumps for liquefied natural gas (LNG). Growth here will be driven by a large number of LNG projects in the pipeline, and synergies derived from its acquisition of German pump maker LEWA in 2009.

Furukawa Electric has a high global market share for optical amplifiers, optical fiber, and copper foil for lithium-ion batteries. Earnings are on an upward trajectory due to the recovery in demand for niche products, especially from the electronics & automotive segment. Proposed Smart Grid projects worth US\$3.4 billion in the US and RMB4 trillion in China by 2020 will drive future demand for Furukawa's superconductive cables. Furukawa is also well-positioned to benefit from the shift towards hybrid and electric vehicles.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Autos	Neutral	Honda
Real Estate	Neutral	Mitsubishi Estate
Energy	Overweight	Inpex
Financials	Underweight	MUFG, Suruga Bank
Materials	Overweight	Nippon Electric Glass, Nippon Steel, Shin-Etsu Chemical
Technology	Overweight	Nidec, Canon, Tokyo Electron, Hoya.
Industrials	Overweight	Fanuc, Kubota
Healthcare	Underweight	Takeda, Sawai Pharmaceutical
Consumer Staples	Neutral	Toyo Suisan
Retail	Neutral	Sundrug, ABC Mart
Info-Comm	Underweight	NTT
Utilities	Underweight	Tokyo Gas



GLOBAL EQUITY STRATEGY

ASIA EX-JAPAN

Equity Strategy

Asian economies are in relatively good shape with most countries running healthy current account surpluses and low government debt-to-GDP ratios. Having registered robust GDP growth in the first quarter of 2010, economic growth is likely to peak in the next two quarters and to cool to moderate levels. Moderating growth will ease inflation pressures. Although concerns over Europe's sovereign debt woes and policy tightening in Asia will persist, we believe the market is pricing these worries in and will focus again on fundamentals.

Our key strategy going forward is to maintain our growth bias and focus on Asia's robust domestic demand. We maintain our overweight positions in the Consumer, Healthcare and Industrials sectors as we target domestic consumption growth in these areas. We downgrade Properties and Financials on policy risks and maintain our underweight position in the relatively slower growth sectors like Telecoms.

Consumer – We maintain our overweight position in this sector as the fundamentals for companies in our portfolio indicate our investment theses are still on track. Although many consumer companies have reported a deceleration in growth rates in recent months, growth still remains at very strong levels. Within the sector, we also remain wary of possible input cost pressures from higher wages and higher soft commodity prices. As such, we position ourselves in companies that are able to pass on cost increases with a preference for market leaders which possess strong brands, higher margins and cash generative business models.

Industrials – We maintain our overweight position in this sector with a positive view in Alternative Energy as key economies like China and India have ramped up their nuclear and wind energy generation targets. Infrastructure plays like Zhuzhou CSR Times Electric and Midas are likely to benefit from continued spending in China's high speed railway and metro sectors. Although companies may face lower margins on rising raw material prices as well as reduced infrastructure spending in China, we believe the strong domestic demand will drive corporate earnings and valuation expansion within the sector.

Conglomerates – We remain neutral in this sector on attractive valuations as conglomerates now trade at decent discounts to their sum-of-parts valuations. We selectively position ourselves in cyclical sectors and expect earnings to rebound as the global economy recovers. We like prime beneficiaries of the global economic recovery such as Hutchison Whampoa, which is exposed to the port, retail and property sectors. Stable oil prices should encourage higher exploration and production spending and lead to more contract flows for Keppel Corporation. Meanwhile, increased gas supply in China will support the earnings growth of gas distributors like Beijing Enterprises.

Financials – We downgrade the sector to an underweight as we see downside risks to earnings expectations. In China, we expect net interest margins, investment income and embedded value expansion to moderate following a likely delay in interest rate hikes. Provisioning costs could also surprise unfavourably in China and Korea. On the flipside, we think Asian banks should be marginally impacted by higher capital adequacy requirements. We prefer banks with resilient earnings, such as those from Singapore and Indonesia.



GLOBAL EQUITY STRATEGY

Real Estate – We downgrade the sector to underweight on renewed policy risks. After a lull in policy measures targeting the China property sector, the Chinese government reintroduced new measures from April 2010, including raising minimum downpayment ratios and making it more stringent for non first-home buyers. Volumes nationwide in China are expected to continue to fall after a 50% month-on-month decline in transaction volumes in May 2010. Prices are also expected to eventually fall by the government's objective of at least 15% to 20%. Apart from Chinese developers, we have also reduced our weights in Hong Kong property developers on slowing transaction volumes.

Technology – We upgrade the sector to overweight on higher sequential demand as we move into the third quarter of the year. Although we remain wary of a potential slowdown in European demand, inventory still remains at healthy levels. In light of rising labour cost pressures, we position ourselves in companies with higher operating margins such as component makers like Largan. We also favour upstream semiconductor manufacturers such as TSMC for their defensiveness and Chinese telecom equipment providers as they are beneficiaries of Mainland China's wireless capital expenditure growth.

Telecom Services – We maintain our underweight position in the Telecom sector as we see a lack of earnings surprise catalysts to drive share price performance in the near term. Nonetheless, the recovery of regional economies should drive usage and subscriber take-up, which will offset the decline in tariffs. Net additions in subscribers should continue regionally, with the strongest growth being in China, India and Indonesia where penetration rates are still low. Capital restructuring within the sector could also lead to higher dividend payouts. Within the sector, we prefer telcos in countries with a low mobile subscriber penetration rate, benign regulatory environment and rising data usage.

Materials – We maintain our underweight in this sector on concerns of a deceleration of economic and industrial production growth in China. Sharp rises in material prices and industry overcapacity are likely to act as headwinds in the sector. On the flip side, we expect government measures that control capacity expansion to benefit existing players with the ability to consolidate smaller companies. Within the sector, we selectively position ourselves in stocks with decent earnings growth and valuations such as paper companies.

Energy – We continue to expect oil prices to be range-bound after its strong rally, but think prices are unlikely to drop significantly due to oil supply discipline and the stabilisation of economic activity. We are of the view that strong demand arising from the economic recovery bodes well for the coal sector. We also favour the upstream exploration and production companies with strong production growth such as CNOOC.

Utilities – We upgrade the sector to a neutral position in this sector on rising power demand driven by strengthening economic activity. While regulatory issues should continue to pose an overhang in China, Korea and Malaysia, we prefer companies which operate in a favorable regulatory environment where they are able to pass on additional fuel cost to customers. In the alternative energy space, particularly in China where capacity is being aggressively expanded, we prefer companies with strong track records who will be able to secure more projects and record strong earnings growth.

Healthcare – We maintain our overweight position in the sector as we expect pharmaceuticals and medical equipment sales to grow strongly on the back of healthcare reforms in China. While we identify rising marketing costs in the short-term and price controls by the government as key risks in this sector, we view this sector as a safe haven given the country's ageing population and favorable government policies.



GLOBAL EQUITY STRATEGY

Key Additions to the Model Portfolio

In the Industrials space, we have added **Zhuzhou CSR**, which offers an attractive investment into the fast growing China high speed railway sector as well as metro car sector. These sectors enjoy government support as they are vital to the improvement of China's transport infrastructure in terms of city-to-city connections as well as intra city transportation. Given the company's strong relationship with China's biggest train maker, China South Locomotive, Zhuzhou CSR is able to win large contract orders, the most recent being the RMB5.1 billion contract to supply electrical systems for CSR Qingdao Sifang Locomotive. In addition, Zhuzhou CSR has obtained cutting edge technology in powered semiconductors which is another focus area for the Chinese government. These powered semiconductors are used in a wide range of industries from high speed railway to metro to smart grid to alternative energy. Zhuzhou CSR's favourable exposure to high growth sectors should secure strong earnings visibility going forward.

In the Utilities sector, we have added **China Everbright** which provides an exposure to the Waste-to-Energy sector, which is still under-penetrated and in an early stage of development. Currently, only 62% of residential waste is properly treated in Mainland China's urban areas. Garbage pile-up could reach 400 million tons for China in 2020, an amount equivalent to the level generated by the entire world in 1997. As such, we expect strong support from the government to encourage waste treatment coverage and expect the industry to grow at a compounded annual growth rate of 20% between 2010 and 2020. China Everbright offers an exposure to a total of 25 projects in Shandong, Jiangsu and Guangdong and Anhui provinces, involving a total investment of about RMB8.6 billion. Its portfolio comprises waste-to-energy, waste water processing, methane-to-energy, straw-fired biomass and solid waste landfill. These projects are highly profitable as they generate higher internal rate of returns compared to water treatment, wind and solar energy. With China Everbright's execution track record and exposure in alternative energy, we expect the company to post strong earnings growth over the next few years.

In the Consumer space, we have added **Zhongsheng Group**, a leading automobile dealership group in China. Zhongsheng has a network of 55 sales, spare parts, service, and survey dealerships in China. Its portfolio comprises luxury brands (Mercedes-Benz, Lexus and Audi) and mid-range to high-end brands (Toyota, Nissan, Honda and General Motors). Sales have been very strong since the beginning of the year, with brands like Toyota and Lexus up 39% year-on-year in the first quarter of 2010. The company's expansion plans are also on track as it currently has 12 stores under construction and has a target to add another 20 stores a year through acquisitions. Pricing is also expected to be generally stable so it is unlikely to face price competition amongst dealers. Inventory levels also remain healthy at around 1.2 to 1.5 months. With growth to be bolstered by organic and inorganic store expansion and higher margins this year, we expect Zhongsheng to post strong earnings growth, potentially beating earnings expectations.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer	Overweight	Alliance Global and Man Wah International
Industrials	Overweight	Zhuzhou CSR and Dongfang Electric
Conglomerates	Underweight	Beijing Enterprises
Financials	Underweight	China Construction Bank and OCBC
Property	Underweight	Hang Lung Properties
Technology	Overweight	TSMC and Largan Precision
Telecoms	Underweight	China Telecom
Materials	Underweight	Shandong Chenming Paper
Energy	Neutral	CNOOC
Utilities	Neutral	China Everbright International
Healthcare	Overweight	China Shineway



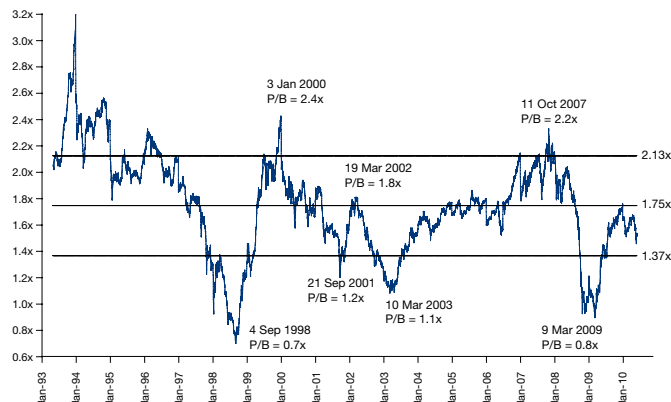
SINGAPORE

Equity Strategy

The Singapore market was hurt by the global rise in risk aversion in the second quarter. From the market peak in mid-April 2010, the Straits Times Index (FSSTI) declined as much as 12.8% when it touched an intra-day low of 2,648 on 25 May 2010. While we do not expect a double-dip recession, the openness of the Singapore economy makes the Singapore equity market vulnerable to sell-offs whenever there are global growth concerns.

If, as we are assuming, the global economy does not enter a double-dip recession, the recent correction has made the Singapore market attractively valued. At less than half standard deviation below mean Price/Book and at one standard deviation below mean Price/Earnings (12-month forward), the market has been cheaper on only three occasions – the 1997 Asian Financial Crisis, the 2003 SARS episode, and the recent Great Recession. As we are of the view that this is a cyclical bull market correction, both our top-down (mean Price/Book of 1.75x on 2010 book) and bottom-up approach derive an FSSTI fair value of 3,200.

Singapore Equities Price/Book Valuations



Source: Citi Investment Research, 8 June 2010

However, the upward earnings revision momentum seen in recent months appears to have stalled. The direct impact of a slowdown in Europe's growth should be limited since exports to Europe makes up just 14% to 15% of Singapore's total exports but there could be a larger indirect impact from slower global growth. If the real economy becomes negatively affected by the ongoing troubles in Europe, there is risk of downward revision to this year and next year's earnings growth of 15% and 10% respectively.

For the third quarter of 2010, we have an overweight stance on the banking stocks as well as selected supply chain managers and conglomerates. We remain cautious on the property developers in general given the potential for more government measures to dampen speculation if transaction volumes stay high. We maintain a tactical exposure to the office sector via **Keppel Land** and the hospitality sector via **CDL Hospitality Trust**.



GLOBAL EQUITY STRATEGY

Key Addition to the Model Portfolio

We are introducing **Pacific Andes Resources Development** to the model portfolio, a cheaper proxy to China Fishery Group, of which it owns 65%. The latter is a progressive industrial fishing company catering to both human consumption and aquaculture needs. China Fishery Group is able to grow through the acquisition of fishing quotas and steadily rising fish prices. It is a cash generative business and China is one of its key markets. Trading at around 8x FY2010 P/E, we view China Fishery Group as undervalued and peg its fair value at S\$2.68 per share. However, we deem its parent Pacific Andes Resources to be more undervalued as the market value of its stake in China Fishery Group is already much more than the current market capitalisation and the profitable frozen fish supply chain management even comes free. We peg Pacific Andes Resources's fair value at 52 cents per share, based on a 10% discount to sum-of-parts valuation (valuing China Fishery Group at our fair value), giving an upside of some 80%.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Underweight	Jardine Cycle & Carriage
Consumer Staples	Underweight	Wilmar International, Pacific Andes
Financials (Banks)	Overweight	OCBC, UOB
Financials (Real Estate)	Overweight	Capitaland , CDL Hospitality Trust, Keppel Land
Healthcare	Neutral	-
Industrials (Capital Goods)	Overweight	Keppel Corporation, SembCorp Industries, Noble
Industrials (Transportation)	Underweight	SIA
Information Technology	Neutral	-
Telecommunications	Underweight	Singapore Telecom



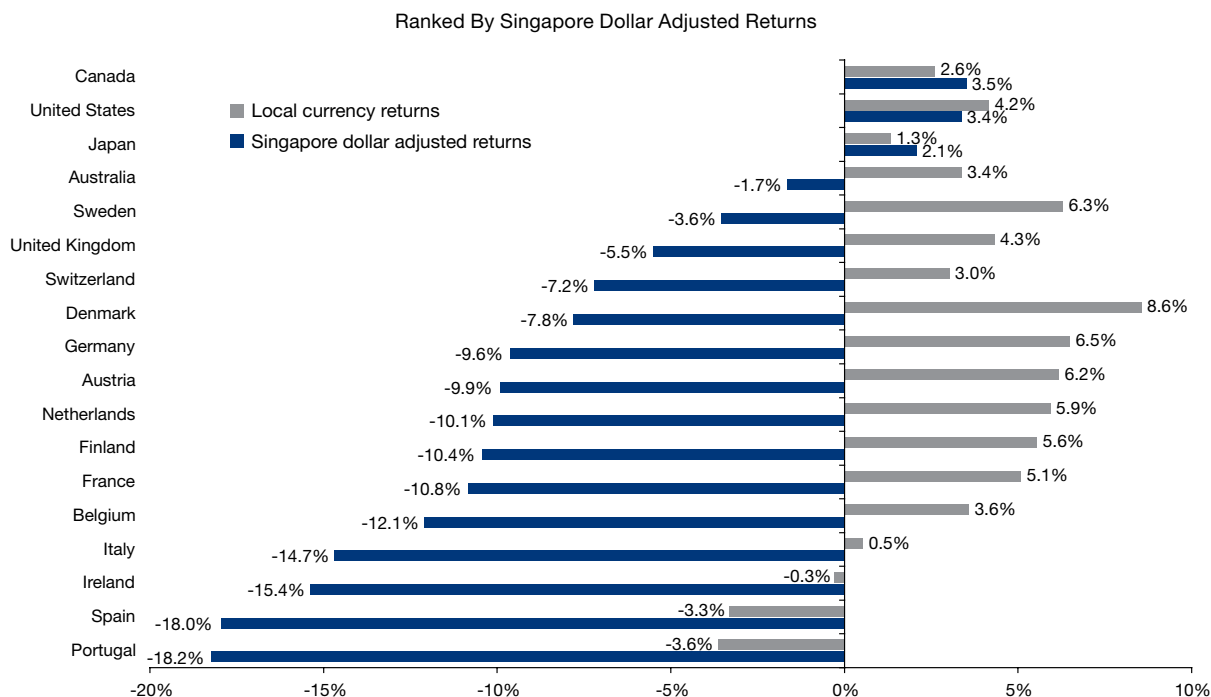
GLOBAL FIXED INCOME STRATEGY



GLOBAL FIXED INCOME STRATEGY

Bond Market Returns

Year to date Bond Market Returns as at 14 June 2010



Source: Bloomberg, 15 June 2010

G-10 FIXED INCOME

Outlook And Strategy

The focus on sovereign debt continued into the second quarter of 2010 and reminded the countries with large and growing fiscal deficits of the low tolerance the bond markets have for burgeoning public debt. Although the spreads of Greek government debt to German government bonds have declined from their worst levels after the announcement of the €750 billion rescue package, they have remained highly elevated. A recent Bloomberg investor poll showed that a large majority of investors are of the opinion that a debt restructuring is inevitable for Greece despite the huge financial aid packages.

The €750 billion aid package is large enough to cover the financing needs of Greece, Spain, Portugal, Italy and Ireland for more or less the next two years but the credit spreads not just of Greece but all of these peripheral countries have continued to stay high as the financial market remains sceptical on the ability of the respective governments' commitment to follow through with their announced budget targets.

Concern on the level of sovereign debt has spread into the European banking sector. This is manifested in the widening borrowing spreads in the money markets. As most of the peripheral European countries' sovereign debt are held by overseas investors (mostly banks), further concerns have been raised on the possibility of worsening sovereign



GLOBAL FIXED INCOME STRATEGY

fiscal positions if the domestic banking sector should need government assistance as losses on those holdings accelerate. Despite the various liquidity enhancing operations by the European Central Bank (ECB) (repo operations, US dollar swap lines with US Federal Reserve) deposits with the central banks have continued to increase to record highs. The current level of deposits with the ECB exceeds the levels experienced during the Lehman Brothers bankruptcy in September 2008. The reluctance of European banks to lend to each other despite all these liquidity enhancing measures is reflective of fear that parts of the European banking sector may be insolvent.

The commitment to consolidate budgets in the coming years is likely to add downward pressure to an already anaemic recovery in the Eurozone, where the economic outlook has become more uncertain with the tightening of credit conditions. Coupled with low inflation and a desire to keep liquidity abundant in the money markets, it is unlikely that the ECB, or any other major central banks for the matter, will raise official interest rates anytime this year. The only caveat is how the bond market will react to increased sovereign debt supply. As European countries struggle with the tighter fiscal situation, the risk of excessively tight fiscal policy increases the probability of choking growth; which could result in larger government expenditure to rescue key institutions. Also, weaker economic growth would lead to weaker tax collection and this could lead to a temporary increase in government debt to supplement the lower revenues as spending tends to be sticky in the short term.

We have an overweight exposure to the core European government bonds in light of the weakened economic prospects and improved outlook on the fiscal stance. The UK's fiscal situation is just as challenging as the peripheral Eurozone economies, and the new UK government's commitment to narrow the fiscal deficit remains to be seen. The UK's core inflation had also been rising more than the other regions and we take a short duration profile in gilts relative to the benchmark. US government debt remains the first choice for investors in this uncertain environment. As long as the US dollar remains a key reserve currency, the dire US fiscal situation remains a worry for another day. For the moment, we have a neutral exposure to US government debt but remain vigilant for a change in sentiment.



GLOBAL FIXED INCOME STRATEGY

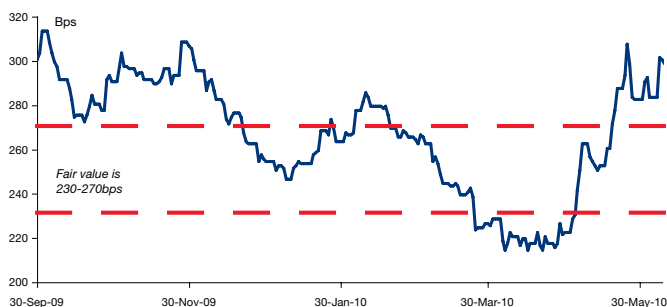
ASIA FIXED INCOME

Outlook And Strategy

The Greek crisis hit the Asian credit market hard in the second quarter of 2010, and Asian credit spreads widened by 73 bps to 298 bps. At 298 bps, the spread was the widest since late November 2009. JACI on a total return basis rose 0.5%¹¹ in the second quarter of 2010.

At a spread of 298 bps, the credit market is pricing in real GDP growth of around 6.5% for Asia. Given that Asia is likely to grow around 7% to 7.5% over the next year, the fair value spread should be around 230 bps to 270 bps. This makes the Asian credit market moderately under-valued by around 10% to 20%.

Asian credit spreads – JACI Index



Source: Bloomberg, 10 June 2010

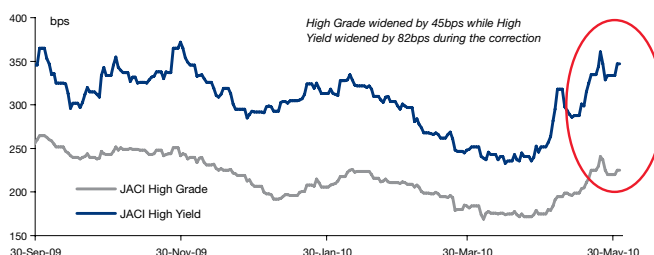
If Asian credit spreads continue their widening trend, to 350 bps, it would be pricing in Asia GDP growth of around 6%. This would provide an attractive level to move into higher risk Asian credits.

Given that the Asian credit market will be well supported by Asia's solid economic fundamentals, the market is unlikely to suffer the same extent of selling as in 2008. However, we believe that sentiment towards the Asian credit market may remain weak over the next three months as more evidence emerges to indicate that China's economic growth is decelerating.

¹¹ Note: As at 10 June 2010

Hence, while we remain constructive on the Asian credit market, we are cognisant of the risks emanating from the Greek crisis as well as the slower growth outlook for China. High grade bonds are therefore likely to outperform high yield bonds in the third quarter of 2010.

Performance of Asian High Grade v Asian High Yield



Source: Bloomberg, 10 June 2010

With a flattening of the US government yield curve, Asian high grade corporate bonds offer an ideal place for global funds to park investments. We prefer the Singapore and Hong Kong high grade names as these two countries are viewed as safe havens. We are underweight the Chinese property sector as it may continue to underperform due to policy risks.

In **High Grade**, we maintain our overweight position in Hong Kong conglomerates, namely **New World Development** and **Henderson Land**. These companies offer decent yield pick-up over similarly rated credits and duration without a compromise in credit quality. We also like defensive triple-A rated bonds like **Areit** 1.6% 01/2017 and the **Singapore Government Securities** 3.25% 01/2020 as these bonds have limited downside in the event of a spike in risk aversion.

In **High Yield**, we prefer good quality corporate bonds like **Adaro** and **Indika** that have strong balance sheets and solid business models. We also like the Philippine container terminal company **ICTSI** as it enjoys strong local support. We also like **Perusahaan Listrik Negara**, a 100% government-owned electricity company, as it offers good yield and also benefits from the structural re-rating of Indonesia.



GLOBAL FIXED INCOME STRATEGY

SECTOR	CREDIT OUTLOOK
Banks	<ul style="list-style-type: none"> Contagion-induced underperformance of Korean bank notes presents a good buying opportunity as the recent weakness has improved valuations. Fundamentals of Korean bank have improved since the 1997 & 2008 Financial Crises along with the economic recovery as well as prudent management of the financial system by the regulators. Supply has been well absorbed by the market and investor confidence has returned with the increase in foreign reserves, which provide a comfortable buffer against short-term external liabilities. Korea's exposure to the Eurozone peripheral economies is minimal and in-line with Asian peers. We also see the possibility of a major armed conflict on the Korea peninsula as remote.
Industrials	<ul style="list-style-type: none"> Our view for the industrial sector remains neutral, while noting potential risks from the Greek crisis. We select corporates that have strong balance sheets and sound business models. We are still slightly negative on shipping as we expect recovery to be slow given the oversupply and low spot freight rates. We continue to see relative value in unrated corporate bonds which give some spread premium over similarly rated issuers. We continue to like the Indonesian coal sector, which we believe will benefit from supportive coal prices and strong demand from China and India, as well as domestic power producers. Trading technicals also remain supportive of this sector. Among the Indonesian coal producers, we like Adaro best given its strong and improving credit metrics and business profile.
Property	<ul style="list-style-type: none"> We are negative on the Chinese property sector, staying cautious as policy noises get louder. We saw a series of measures in April to curtail speculative demand especially in the high-end segment and Tier 1 cities. These measures have hit sentiment, leading to lower contracted sales and lower selling prices in May 2010. Fear of more draconian policy tightening has brought about poor performance in Chinese property sector bonds. While we note that the better quality names have strength in their balance sheets to withstand downside risks, the sector might still underperform in light of these risks. We prefer to stay invested in the unrated Hong Kong developers which provide premiums over similarly rated issuers.
Oil & Gas	<ul style="list-style-type: none"> Refining margins continue to recover from their bottom in the fourth quarter of 2009. However valuations of the Korean refineries remain expensive versus other Korean quasi-sovereigns, despite the recent market correction. Hence we are maintaining an underweight on this sector.
Utilities	<ul style="list-style-type: none"> We like this sector for its defensive qualities, to help ride out the current market volatility. The economic recovery across most Asian countries remains intact, and this means stronger revenue growth for utility companies in general, while fuel cost increases remain manageable. Our top picks in this sector are CLP Power Hong Kong (high grade), and Cikarang Listrindo (high yield). CLP Power has strong stand-alone credit metrics and operates under a favorable and consistent regulatory framework in Hong Kong. Cikarang has strong credit metrics for its rating and enjoys robust captive demand in its service area. Cikarang's 2015 bond was well supported during the recent market correction. We also remain positive on the Korean utilities, and would participate in new issuances with attractive valuations. We continue to believe that the fuel pass-through mechanism will be implemented in July 2011 as guided by the Korean Ministry of Knowledge Economy.
Consumer	<ul style="list-style-type: none"> Although we believe fundamentals will remain supported by resilient consumer spending, we are neutral on this sector due to the lack of superior risk-reward opportunities. Our top pick is Parkson's 2012 bond.
Telecommunication	<ul style="list-style-type: none"> We expect to see continued subscriber growth and also increased average revenue per user, driven by the roll-out of new services, as well as mobile and broadband network expansion in most countries. In addition, competition between telcos in Korea and Indonesia has subsided, and margin pressure should ease further. Despite its defensive qualities, valuations remain expensive in general; hence, we are neutral on this sector. That said, consolidation in the Indonesian telco industry may create selective buying opportunities in the second half of 2010.



GLOBAL FIXED INCOME STRATEGY

SINGAPORE FIXED INCOME

Second Quarter Review

Real GDP grew at 15.5% year-on-year in the first quarter of 2010, much higher than consensus estimate of a 11% rise. On a quarter-on-quarter seasonally adjusted annualised basis, real GDP rose 38.6% from -4.3% in the previous quarter. The Monetary Authority of Singapore (MAS) noted that the output gap has turned positive, which could trigger inflationary pressures in the second half of 2010. We calculate that Singapore's economy is now more than 3% above its previous peak in the first quarter of 2008. The recovery was broad-based, with manufacturing surging 32.9% year-on-year, services growth doubling to 10.9% and construction growing 13.8%.

The government upgraded its 2010 GDP growth forecast to 7% - 9% from 4.5% - 6.5% and its inflation forecast to 2.5% - 3.5% from 2% - 3%. We expect real GDP growth of 7.5% for the full year of 2010. The government noted that the upward pressure on inflation is likely to come from higher commodity prices, private road transport costs, as well as other sources of domestic inflation pressure. The government also noted that the global economy is showing "further signs of improvement", with the US recovery helped by an improvement in its labour market and Asian growth supported by China's demand for electronics and commodities.

On 14 April 2010, the MAS surprised the market by tightening its monetary policy much more aggressively than expected. The MAS announced a one-off re-centering upwards of the Singapore Dollar Nominal Effective Exchange Rate (SGD NEER) as well as resuming a "modest and gradual" appreciation of the SGD NEER. The new mid band is estimated to be around 250 bps above the old mid band. We believe that the new slope is likely to be around 1-2% per annum, which will be similar to the "modest and gradual appreciation" seen between April 2004 and October 2007. The Singapore dollar appreciated to below 1.38 against the US dollar shortly after the tightening but has since weakened to 1.41 on the back of the Greece crisis. We expect the Singapore dollar to weaken further to around 1.42 - 1.43 in the third quarter due to a slowdown in China's economy.

Outlook And Strategy

US Treasuries (USTs) rallied in the second quarter of 2010 as the crisis in Greece continued to spook the market. The UST curve "bull flattened", i.e. yields at the short end fell. The yield on two-year USTs fell 32 bps to 0.74% while the yield on 10-year USTs fell 65 bps to 3.21%. The 2-10 curve flattened by 33.2 bps to 2.47%.

Singapore Government Securities (SGS) also rallied in the second quarter. The two-year SGS yield fell 15 bps to 0.46% while the 10-year SGS yield fell 22 bps to 2.62%. Consequently, the 2-10 spread flattened by 19 bps, to 2.16%.

Given the heightened risk aversion, we have now turned bullish on the long-end SGS. In particular, we like the **Singapore Government Securities 3.25% 2020** as its current yield of 2.65% is 20 bps to 25 bps higher than its fair value yield. We also like AAA-rated **Areit 1.6% 01/2017** (putable at par in 2015), which is currently yielding 3.0% or 215 bps higher than the five-year SGS.



CURRENCIES



Second Quarter Review

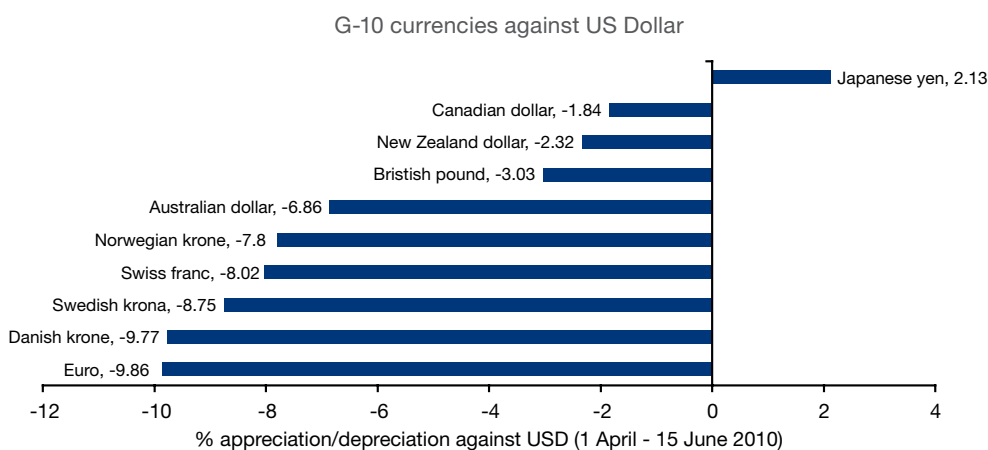
The US dollar continued to strengthen in the second quarter of 2010 as investors retreated from risk and there was a further flight to safety. The rise in risk aversion was due to the worsening of the sovereign debt crisis in Europe, and the Euro suffered the biggest decline among the G10 currencies, falling close to 10%¹² against the US dollar. The common currency continued to come under pressure even after the announcement of the €750 billion stabilisation package. While the rescue package should prevent a liquidity crisis the market is sceptical that the solvency question has been solved.

The Japanese yen rose during the second quarter. Similar to the US dollar, the yen benefited from the overall flight to safety. The yen weakened slightly upon the resignation of the Japanese Prime Minister Mr. Yukio Hatoyama and the subsequent election of the Finance Minister, Mr. Naoto Kan as the new leader. Mr. Kan is known to favour a weaker yen, and there is speculation that the new Kan government could attempt to engineer weakness in the currency.

Asian currencies were slightly weaker over the second quarter. During the first quarter of this year, Asian currencies had continued to strengthen even as risk aversion rose and the euro declined. In recent years, Asian currencies have become more sensitive to China's macro economic outlook and the growing fears of a hard landing in China and the global rise in volatility led to some selling off in Asian currencies. The sharpest decline was in the Korean won as tension with North Korea resurfaced during the quarter. As at 15 June 2010, the Asian dollar index was back to the level it began the year.

The announcement by China towards the end of June 2010 that it was allowing more "flexibility" for the renminbi was greeted positively by the market. Unlike the episode in July 2005 when the renminbi underwent a one-off 2% revaluation overnight, the Chinese authorities made it clear that they were not in favour of a sharp and rapid appreciation of the renminbi this time. Following the announcement, the futures market was pricing a 2.3% appreciation of the renminbi over the coming 12 months.

The commodity currencies also performed relatively poorly in the second quarter as concerns about global growth increased and commodity prices declined. The Reserve Bank of Australia, who has been at the forefront of raising policy rates, kept its cash rate unchanged at 4.5% at its June meeting.



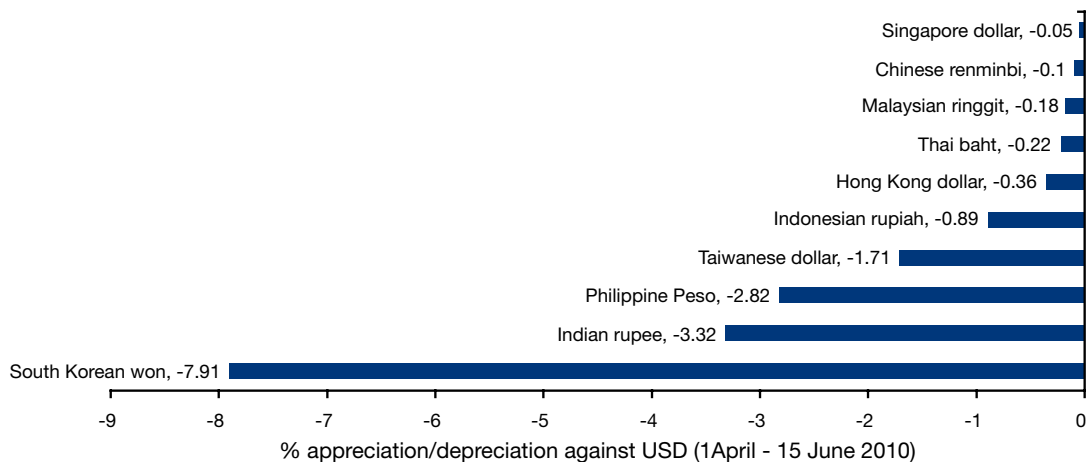
Source: Bloomberg, 15 June 2010

¹² Note: 1 April 2010 to 15 June 2010



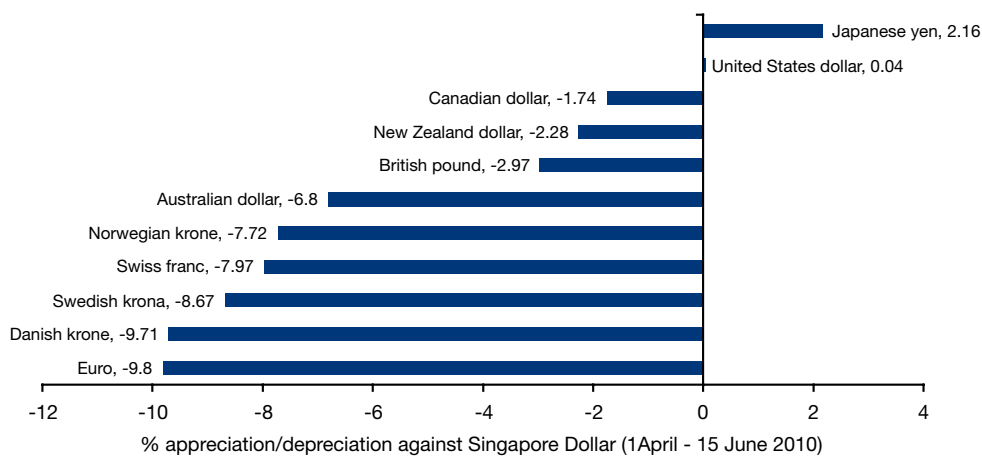
CURRENCIES

US dollar against Asian currencies



Source: Bloomberg, 15 June 2010

G10 currencies against Singapore dollar



Source: Bloomberg, 15 June 2010



CURRENCIES

Outlook And Strategy

It is likely that the US dollar will remain strong in the coming quarter as the performance of the US economy continues to be relatively strong among the developed economies. Although it is unlikely that the Fed will raise interest rates in 2010, it is still likely to begin normalisation before the ECB. While the US also has a problem with its growing fiscal deficit, the US dollar continues to benefit from its status as a global reserve currency.

The current strength of the US dollar is largely being driven the weakness in the euro, a situation which is unlikely to change in the third quarter. The austerity programme for Greece is ambitious and the risk that Greece may not meet its debt repayments at some point down the road has meant that the unity of the European Union is being questioned and this has put a new risk premium on the euro. Until this crisis, the euro had benefited from the diversification of global central banks of their foreign reserves holdings (from the US dollar to the euro) but this is likely to have come to a halt. A weak euro is also beneficial for Europe's export sector and would be welcomed as a means of offsetting the overall tightening in fiscal budgets, which is occurring even in Germany.

The Japanese currency is strongly driven by the difference in the interest rates between the US and Japan and also the carry trade. Both are related to risk appetite. If risk appetite picks up, US interest rates rise and volatility declines, the Japanese yen would resume weakening. We expect risk appetite to stay subdued in the near term and the Japanese yen to remain range bound at USDJPY 90 to 95.

Although the renminbi and the Asian currencies now have a tailwind behind them we believe the appreciation of the renminbi will be modest over the coming 12 months, in the range of 1-1.5%. For the third quarter we expect Asian currencies to continue declining modestly. As mentioned, Asian currencies are increasingly driven by the macroeconomic outlook in China and we expect to see softer leading indicators in China in the third quarter. Among the different Asian currencies, we expect the Indonesian rupiah and the Indian rupee to outperform as they have attractive "carry" and are attractively valued.

CURRENCY FORECAST		
Currency	Against USD 15 June 2010	Forecast End 3Q 2010
Japanese Yen (JPY)	91	95
Euro (EUR)	1.22	1.20
Singapore dollar (SGD)	1.40	1.37

Source: Forecast figures are consensus numbers from Bloomberg, 15 June 2010



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