Global Equity

EQUITIES	1 Mth (%)	3 Mth (%)	6 Mth (%)	YTD (%)	3 Yrs (%)
MSCI AC World	1.2	2.9	-2.9	4.7	0.5
MSCI World	0.8	2.8	-2.5	4.9	1.3
MSCI Emerging Markets	4.1	3.6	-6.1	3.5	-4.5
MSCI USA	0.7	2.4	-0.5	8.3	18.9
MSCI Canada	1.7	6.3	-1.7	0.8	-1.9
MSCI Europe	1.1	4.7	-4.1	2.2	-15.8
MSCI Japan	-0.3	-4.9	-11.4	-5.3	-19.6
MSCI Australia	0.4	5.3	-0.2	4.0	-6.5
MSCI AC Asia Ex-Japan	5.0	4.9	-2.6	7.1	-0.9
MSCI Latin America	2.1	1.0	-12.7	-3.5	-13.3
MSCI EMEA	2.5	4.2	-5.6	5.6	-0.8

Returns in Singapore dollars. Source: Datastream, October 2012

Global equity markets advanced in September underpinned by additional quantitative easing (QE) measures by the European Central Bank (ECB), the US Federal Reserve and the Bank of Japan. But disagreements among European leaders over the fiscal compact and banking union agreements cast doubts that the euro zone crisis is on the mend. For the month, the MSCI AC World Index was up 2.9% in US dollar terms, with performance in the Emerging Markets almost double that of the Developed Markets. Among the developed markets, Japan was the worst performing one as recession risk rose. The rally was not dominated by the cyclical sectors as the Consumer, Energy and Industrial Sectors underperformed the market.

Growth indicators in the developed countries continued to stall or contract while the outlook for corporate earnings deteriorated across sectors. However, earnings estimates especially for FY 2013 remain too high given the weak macro-environment. Among the developed markets, we continue to prefer the US equity market. Despite growing headwinds in the US, the market remains better positioned to cope with the stress in the global economy. Our least preferred market is Europe given that the almost 3-year sovereign debt problem is far from being resolved and remains a significant risk.

Although the US market held up better relative to its developed peers, its economy is slowing down rapidly. Second quarter US real GDP grew by a weaker-than-expected 1.3% after growing 2% in the first quarter. This is well below the US's growth potential as reflected by a persistently high unemployment rate and unusually weak income growth. According to the Business Roundtable survey, the Association's quarterly economic outlook index fell to 66 in the third quarter from 89.1 previously. In turn, this is impacting corporate America as there have been more US companies, such as Intel and Caterpillar, providing negative earnings outlook. Despite the lack of growth catalysts, the MSCI US Index advanced by 2.4% in US dollar terms, largely on the back of the third QE. Although we continue to have a positive stance on US equities, we consider it prudent to increasingly adopt a bigger bias towards less cyclical companies and those with sustainable cash flow.

Global Equity

Despite deteriorating economic fundamentals, the MSCI Europe Index went up by 2.8% bolstered by optimism that the ECB's Outright Monetary Transactions (OMT) would be effective in controlling the sovereign debt problem. Although the OMT helped prevent the sovereign bond yields from rising excessively, the challenges ahead remain daunting. Currently, the measures to resolve Europe's debt problem, including the earlier proposed banking union and fiscal compact, have serious implementation risks. Any debt reduction efforts would be further complicated by Europe's deepening recession, which would inevitably raise doubts about the fiscal adjustments in the peripheral countries as social tension and austerity fatigue intensify. The risk of one of these peripheral countries leaving the Euro within a year has not diminished. Yet, there is no adequate firewall to contain the fallout from such an event. Spain is likely to apply for a bailout package soon thus increasing the burden on the creditor nations. The European Composite Purchasing Managers' Index (PMI) remained subdued at 45.9 in September compared with an average of 46 in the July-August period. The European Commission's monthly survey results confirmed this situation, with a euro zone business confidence index sagging from 89.7 in June to 86.1 in August. Europe remains our biggest Underweight.

Despite the Bank of Japan's JPY10 trillion asset purchase programme announced in September, the Japan equity market was the worst performing market in the month. This underscores our belief that a sustainable rally needs to be followed by fundamental economic and corporate improvements. Investor sentiment was hit by weak economic indicators, which showed a rapidly slowing Japanese economy at the brink of a recession. After a strong start to 2012 as a result of the reconstruction spending, Japan's second quarter GDP growth collapsed to 0.2% quarter-on-quarter (q-o-q) from 1.3% in the first quarter. The PMI for September continued to fall below 50 for the fourth consecutive month, suggesting further weakness ahead for the Japanese economy. Hence, a combination of weak exports and stalling domestic demand makes Japanese corporate earnings vulnerable to downgrades. With parliamentary elections expected in the coming months, policy uncertainty remains despite the need to make critical decisions on Japan's fiscal and energy future. Japan is the second most indebted country in the world with a fiscal deficit that is estimated at -10% in 2012. We continue to rate the Japan equity market an "Underweight".

The Emerging markets produced strong returns and outperformed the developed equity markets, led by the Asia (ex-Japan) equity market which produced a return of 6.8% in US dollar terms. The top performing Asian markets were India, Thailand and Taiwan. India's rally was supported by the government's reform measures including a relaxation of foreign investment limits as well as measures to bolster the domestic economy. In Thailand and Taiwan, the rally was supported by favourable data including Taiwan's better-than-expected industrial production growth of 1.9% in August compared with market expectations of a 0.4% contraction. However, the export-oriented Asia remains vulnerable to an European recession and a China hard landing. New orders for the US, Europe and China have all contracted simultaneously since June. Although there has been some recovery at the point of writing (in the US and China), we are not confident that the recovery is sustainable given the falling business confidence worldwide. Overall, we remain selectively positive on Asia given its relatively healthier fiscal positions and growing urbanization.

EMEA also performed strongly in the month under review led by Egypt, Hungary and Poland. The MSCI Egypt Index rose by 9.1% in US dollar terms as the political environment continues to improve, which in turn, has helped the government secure the much needed financing from several creditor nations to fund various infrastructure projects. In line with the improving investor sentiment following ECB actions in September, Eastern European countries such as Poland and Hungary also performed well. The Russian equity market continued to advance in September after being admitted to the World Trade Organisation (WTO) in August. The oil price rally during June to September, as a result of the geopolitical risk, continued to benefit Russia.

Global Equity

The Latin America market underperformed their emerging market peers in the month under review due mainly to Chile, Peru and Brazil. These countries were impacted by weak international trade and falling commodity demand. Mexico was the strongest performing market, aided by its economic proximity to the American economy. Although the region's performance has been disappointing year-to-date, we remain positive on the Latin America market given an expected acceleration in GDP growth in countries such as Brazil. Moreover, the region's strong fiscal position and relatively low sovereign debt levels position the region well in the current weak macro-economic environment.

Generally, our asset allocation decisions have not changed. Despite the improvement in risk appetite, we remain wary of the three macro-economic risks viz., the unresolved sovereign debt risk in Europe, the looming US fiscal cliff and a possible hard landing in China. These have magnified the uncertainty in the global system and increased the risk for a serious slowdown in the world economy. In turn, this would be unfavourable for corporate earnings. The generous liquidity support from the major central banks around the world will continue to keep interest rates at very low levels for an extended period of time. This implies that the market will stay volatile. In such an environment, however, rigorous and careful fundamental analysis yields results. Accordingly, we remain focused on high quality and sustainable growth franchises even as the operating conditions remain challenging.

Outlook and Strategy

	Policy	Change	Comment
US	Overweight	–	The earnings outlook continues to deteriorate and companies have issued more negative outlook statements. As such, earnings are revised down especially in the Energy, Materials and Information Technology sectors. Consumer Discretionary and Utilities held up better in terms of earnings revisions. However, the earnings per share (EPS) growth trend continues to outperform the other developed markets. Valuations remain compelling with multiples below long-term average while earnings yield gap is at all-time high. **OVERWEIGHT**.
Europe	Underweight	–	Earnings downgrades momentum continued to accelerate in Europe, making the Q2 2012 results reporting season the worst one since the Lehman crisis. Although earnings estimates for 2012 have been adjusted down, 2013 EPS estimates remain far too optimistic. Consensus EPS growth for 2012 and 2013 are -1.8% and 12.0% respectively. Using a trend-adjusted price/earnings ratio (PER), the European market does not look cheap relative to its 5-year average. **UNDERWEIGHT**.

Global Equity

	Policy	Change	Comment
Asia (ex-Japan)	Overweight	–	Earnings momentum has stalled as economic growth slows but it continues to hold up better compared with most markets. However, we anticipate more negative earnings revisions ahead as Asia is particularly vulnerable to the weak global demand and a slowing China. Nevertheless, Asia continues to offer positive structural growth factors such as a burgeoning middle income class. **OVERWEIGHT**.
Japan	Underweight	–	Japan's earnings revisions remain negative as the operating environment deteriorates both domestically and overseas. Domestic consumption is likely to roll-over as fiscal incentives such as the car subsidy ends in September this year. Despite the earnings downgrades, 2013 earnings are still too optimistic. **UNDERWEIGHT**.
Latin America	Overweight	–	Earnings momentum continues to decelerate in tandem with slowing global growth. The cyclical sectors such as Energy and Materials saw the biggest negative earnings revisions while the defensive sectors like Utilities held up better. Latam trades at 10.6x consensus forward P/E which is in line with historical average of 10.1x. We continue to favour the region on positive long-term drivers such as low debt levels, rising wages and increased infrastructure investment. **OVERWEIGHT**.
EMEA	Underweight	–	The outlook for EMEA is mixed with growth prospects in Central and Eastern Europe weaker due to their close financial and trade links with Western Europe. Earnings downgrades continued in EMEA across most sectors during the Q2 2012 results season, except for Telecoms; and amongst the large EMEA countries, Turkey has seen the best earnings revision (with only a 0.9% decline). Although we like the longer term consumption growth story and the emergence of a middle class, the region, however, is particularly vulnerable to the risks in Europe. There is also growing political risk in several EMEA economies. **UNDERWEIGHT**.

All statistics quoted in the write-up are sourced from Bloomberg as of October 2012 unless otherwise stated.

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