



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	1.2	5.0	1.2	6.7
MSCI World	1.9	5.8	1.9	6.4
MSCI USA	2.0	7.5	2.0	9.4
MSCI Europe	3.5	2.5	3.5	1.6
MSCI Japan	0.1	8.5	0.1	1.2
MSCI AC Asia ex-Japan	-1.4	1.5	-1.4	12.3
MSCI Emerging Markets	-3.1	0.0	-3.1	9.1

Returns in Singapore dollars. Source: Bloomberg, 31 January 2011

Developed equity markets continued to push higher in January, although emerging equity markets fell. The MSCI AC World Index rose by 1.5%, while the MSCI World Index rose 2.2%, measured in US dollar terms. MSCI Europe was the strongest region, up 3.8% in that month.

Economic recovery continued to broaden out, with the US Services PMI reaching 59.4% in January – a signal that the recovery in the manufacturing sector was broadening to the services sector. Meanwhile, concerns over the Euro and the weaker peripheral countries abated. Leading indicators continue to point towards recovery, and economic growth expectations in the US and Europe (core EU) are starting to be revised upwards. Meanwhile, markets continue to anticipate more favourable legislation that should support of job growth and private sector investment. Specifically, expectations are that a comprehensive corporate tax reform bill could pass as early as end-2011.

As we discussed at the end of 2010, inflation is a growing concern, especially in the emerging world. Higher food and energy prices are exerting upward pressure on the CPI. Meanwhile, higher input prices are putting upward pressure on PPI. The heavier weighting on food and energy in consumer baskets in the emerging world is a source of concern. This, coupled with overly accommodative currency and monetary policies as well as strong capital inflows, has translated quickly (via wages) into higher domestic costs. Concerns that many central banks in Asia and Latin America could be behind the curve in fighting inflation, led to a significant reversal in capital flows out of Emerging Market Equities. While we like the longer term outlook for emerging markets, in term of both



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economic growth as well as a place to invest, we have temporarily reduce our exposure back to benchmark levels.

China's CPI inflation rose slightly to 4.9% in January after easing a bit in December. Recent surges in food prices and concerns over a drought in China only exacerbate the challenge. Brazil and India (rural) registered CPI inflation of 6.0% and 8.4% respectively in January and December respectively. What is clear in the China data is that input prices are rising faster than output prices. Purchasing prices advanced by 9.7% in November, while Producer Prices rose by 6.6%. This suggests that a potential squeeze on margins lies ahead until inflation can be brought down. Meanwhile, higher policy rates bode ill for equity market valuations, especially given the uncertainty over the extent of tightening required.

#### OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Overweight	–	The mid-term elections resulted in a policy shift that brought renewed confidence to the corporate sector that should help to underpin the recovery. Meanwhile, employment data has picked up and consumption data has been favourable, suggesting that the recovery is pretty well entrenched. The corporate sector is in a strong position to grow into recovery. We continue to favour the US over other developed regions. <b>OVERWEIGHT.</b>
Europe	Underweight	↑	The outlook in Europe is increasingly divergent, with the peripheral countries' problems weighing on the broader region and the Euro. While employment in the core has held up favourably, the situation in the periphery looks increasingly dire. We have none-the-less increased our exposure to the region given its attractive valuations and opportunities outside of the financial sector. <b>UNDERWEIGHT.</b>
Asia (ex-Japan)	Neutral	–	Inflation data in Asia is a problem, and further policy tightening is inevitable, especially in China and India. The shift in policy bias is coming at a time when the cyclical recovery is moderating due to base effects. Although the longer term growth outlook still remains favourable, the policy shift could pose a significant headwind to market performance. We remain more defensive, focused on sectors where pricing power should be stronger. <b>NEUTRAL.</b>
Japan	Neutral	↑	A stronger Yen continues to be a challenge for exporters and poses a risk of earnings downgrades. However, Japanese companies are reasonably positioned for the rebound in technology spending and industrial investment. The corporate sector is well-positioned from a recovery in global growth and domestic prices are stabilising. <b>NEUTRAL.</b>



Latin America	Overweight	↓	Latin America continues to benefit from strong domestic demand and a renewed investment cycle. The region's need to replenish on enhance its capital stock positions it well on a multi-year view. Inflation is a near term concern. And we have reduced our position. <b>OVERWEIGHT.</b>
EMEA	Neutral	↓	EMEA (Eastern Europe, Middle East & Africa) outlook varies by region. Growth prospects in Eastern Europe remain favourable, while the outlook in Africa is deteriorating. The longer term story for the industrial parts of Eastern Europe (Czech Republic and Poland) remain favourable as do prospects for resource rich Russia. <b>NEUTRAL.</b>

The Developed world now appears to be on a firm path of sustained recovery, and despite continued household de-leveraging, growth is again recovering to closer to potential. However, we note a de-coupling of policy between the US and Europe, with US policy remaining decidedly more accommodative. Further adding to policy divergence are the challenges faced by the periphery countries in the Euro zone. Our investment strategy is bias towards sectors that are benefiting from a renewed investment cycle. We favour the US to Europe and Japan, but have increased our exposures to all the developed regions.

Inflation is a key risk in the emerging world and growth is at risk of slowing sharply in lag to policy tightening measures. As inflation remains a problem concerns over corporate earnings increase. We have adopted more defensive strategies and have focused our attention on sectors and companies with greater pricing power. Our favoured region remains Latin America, where policy rates have been lifted aggressively, but capacity constraints remain a concern.

Against a backdrop of accelerating growth in the developed world, equity valuations remain very attractive. However, the evolving operating environment may bring additional challenges in 2011 and test business models. We continue to focus on high quality franchises that have sufficient pricing power to manage in an environment where input costs may rise.



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