



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	4.2	5.6	0.9	0.9
MSCI World	4.3	5.8	0.1	0.1
MSCI USA	3.5	7.7	3.4	3.4
MSCI Europe	5.3	1.5	-7.7	-7.7
MSCI Japan	4.0	8.7	2.4	2.4
MSCI AC Asia ex-Japan	2.5	3.8	6.9	6.9
MSCI Emerging Markets	4.0	4.4	6.3	6.3

Returns in Singapore dollars. Source: Bloomberg, 31 December 2010

Equity markets rebounded strongly in December. The MSCI AC World Index rose by 7.2% in December and ended the year up 10.4%, measured in US dollar terms. Developed Markets rose by 10%, while Emerging Markets were up by 16%. After falling sharply in November on concerns of public sector debt, European markets led the rebound.

Strong leading indicators pointed towards a recovery in business confidence, while labour market indicators started to improve. Meanwhile, US mid-term elections brought about a significant shift in policy direction that should have positive implications for investors. The mid-term “shellacking” sent a strong signal that Obama’s administration was not adequately addressing the public’s main concern, namely jobs. Recent administration appointments suggest a significant shift to the middle, with a return of a number of former President Clinton’s key staff with strong business connections. New legislation has already been put in place to extend payroll tax credits and allow for accelerated write-off of capital investment. Expectations are now building that a comprehensive corporate tax reform bill could pass as early as by end of 2011.

Inflation is an increasing concern, especially in the emerging world. Higher food and energy prices are placing upward pressure on the CPI. Meanwhile higher input prices are putting upward pressure on PPI. The heavier weighting of food and energy in consumer baskets in the emerging world is a source of concern. This coupled with overly accommodative currency and monetary policies and strong capital inflows is translating quickly via wages into higher domestic costs.



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China reported CPI inflation of 5.1% in November, while Brazil and India registered CPI inflation of 5.9% and 8.3% respectively in December. 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 6.1%. This suggests a potential squeeze on margins lies ahead until inflation can be brought down.

OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Overweight	–	The mid-term election 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. OVERWEIGHT.
Europe	Underweight	–	The outlook in Europe is increasingly divergent, with the fringe country 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. Contagion risk to the broader Euro-zone through the currency union and banking system linkages is a real concern. UNDERWEIGHT.
Asia (ex-Japan)	Neutral	–	Inflation 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. NEUTRAL.
Japan	Underweight	–	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. Corporate profitability still needs to recover further before we can justify further capital allocation. UNDERWEIGHT.



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. However, inflation is becoming a greater concern. And while the Brazil Central Bank was early to tighten, inflationary pressures remain stubbornly strong. OVERWEIGHT.
EMEA	Overweight	–	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. OVERWEIGHT.

The Developed world now appears to be on a firm path of sustained recovery, albeit below potential due to continued household de-leveraging and public sector consolidation. 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, and continue to look for global businesses that are leveraged into the growth of emerging markets.

Growth rates in the emerging world have decelerated sharply and may fall further. As inflation remains a problem, we have adopted more defensive strategies and have focused our attention back on sectors and companies with greater pricing power. Our favoured region remains Latin America, where policy rates have been lifted aggressively and where exchange rates have risen more freely to stem imported inflation.

Against a backdrop of moderate 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 through and environment where input costs may rise.



Market Commentary

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