



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	-7.9	-4.6	-7.7	8.8
MSCI World	-8.0	-5.1	-7.9	7.8
MSCI USA	-5.9	-1.5	-2.3	15.3
MSCI Europe	-11.1	-10.8	-17.9	-1.8
MSCI Japan	-6.2	-4.9	-2.7	-0.3
MSCI AC Asia ex-Japan	-6.8	-0.8	-6.5	13.3
MSCI Emerging Markets	-7.2	-1.4	-6.7	16.0

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

World equity markets fell sharply in May, with the MSCI AC World Index down nearly 10% in US dollar terms. European markets led the decline, off by more than 13 percent in the month and nearly 20% year to date. The Greek issues which started to buffet European markets in late April resulted in a sharp increase in risk aversion and a broad scale drop in risk assets, including equities. No region was spared, with returns for the year now all in negative territory. The Euro Stoxx 600 Index fell nearly 6% in Euro terms, and by almost 13% in US dollar terms, as the Euro continued to decline. The Euro fell from 1.32 against the US dollar to end the month at 1.23.

While economic indicators continue to point to a broadening recovery, some indicators appear to have peaked. Markets have started to stabilise following the passage of a rescue package in the Eurozone designed to cover the refinancing needs of the more extended economies. Nonetheless investors remain concerned over the broader growth outlook as governments face increased pressure to rein in deficits. Adding to concern is the ongoing tightening in China. A backdrop of more rapid fiscal adjustments could represent a strong headwind to the cyclical recovery. This is of particular concern in the UK and the Eurozone.



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**BEST FUND GROUP (OVERALL)**



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**BEST MIXED ASSETS FUND GROUP**



In the UK, a new government formed via a coalition between the Conservatives and the Liberal Democrats has settled into No.10 Downing Street. Among the top agenda items cited by the Cameron-Clegg partnership is a need to address the budget deficit. In Germany, after losing control of the Upper House following the North Rhine Westphalia elections, Merkel's centre right alliance has started to put forward more aggressive plans to rein in public spending, with a budget reduction of up to €80bn targeted. The German move is largely in response to calls to support some of its weaker Southern neighbors and is a signal to its fellow Euro partners that fiscal restraint is expected.

Observers have variously described the current recovery as a **V**, **W** or **VL**. We have been more in the **VL** camp, given our view that private sector de-leveraging will be a significant headwind to global growth. Developments over the past month or so, with markets getting increasingly jittery about public debt, and with governments signaling potential deficit reductions cause us to wonder whether we may be in store for a **VS** type recovery, a cyclical bounce back followed by a subsequent slide. The "S" representing the beginning of policy mistakes that sets us on a slippery slope. This could truly have the makings of a Greek tragedy.

While we have been concerned about the fiscal drag ahead, we are now more concerned about a premature or abrupt withdrawal of fiscal stimulus. The good news is that economic indicators in the US and Europe remain in positive territory, corporate profits remain strong, inflation is not a significant risk, and valuations are reasonable.

## OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Overweight	–	The US economy has bottomed and there are signs that the industrial recovery is broadening out. The housing market appears to have stabilised and 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 vs. growth prompt us to stay Overweight.
Europe	Underweight	–	Leading indicators in Europe have rebounded sharply. However 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 prompt us to stay Underweight.



Asia (ex-Japan)	Overweight	–	Growth in Asia continues to be strong. However, China's decision to tighten monetary conditions to address an overheating property market and reverse some of its prior stimulus, have raised concerns. Strong upward wage adjustments raise questions about corporate earnings and add to inflation concerns. This prompts us to adopt a more defensive stance, focused on domestic consumption.
Japan	Underweight	–	While Japanese corporate profits are projected to rebound sharply in the current year and next, core operating performance leaves much to be desired. Recent Yen strength has weighed on exporters. Corporate profitability still needs to recover further before we can justify further capital allocation. We are slightly Underweight.
Latin America	Overweight	–	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, central banks are generally ahead of the curve in fighting inflation, most notably in Brazil. The region continues to offer strong long term investment opportunities for equity investors. We remain Overweight.

In the Developed world, extended debt levels are expected to constrain both consumer and public sector spending. We are hopeful that business investment will take the baton from Governments and that employment strengthens. The US seems to have turned the corner, with improving indicators signaling that the economy has stabilized. However, the UK and the Eurozone pose continued risks, especially in the face of market imposed and politically mandated budget reductions. This places large parts of the Developed world uncomfortably close to the cusp of asset price deflation, the key risk of 2010.

While the Emerging world has faced overheating pressures, we believe the worst is behind us. Many have responded to this pressure by lifting policy rates, Brazil having demonstrated the greatest discipline. China, having put in place excessively stimulative fiscal monetary conditions last year, has started to tighten monetary conditions. Of the major developing markets, China is probably the most at risk of policy missteps given the extensive period of unchecked credit growth and fixed asset investment. Recent policies have been designed to remedy this risk, although the outcome will only become clear in time. While the longer term prospects for Emerging Markets remain favorable, expectations of further tightening measures will likely constrain near term performance. We continue to focus our investment strategies on domestically driven growth opportunities within Emerging Markets.

While 2010 continues to look to be a favorable environment for corporate profits, macro factors have the potential to destabilise financial markets. We are less concerned about inflation risk and the need to raise rates than about a potential growth shock due to abrupt fiscal consolidation. While equity valuations suggest meaningful upside, earnings risks may have shifted slightly to the downside. Meanwhile, the fiscal consolidation process poses an ongoing challenge.



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