



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	1.8	3.8	-2.8	3.4
MSCI World	1.9	3.4	-3.6	2.1
MSCI USA	2.1	2.6	-2.0	5.9
MSCI Europe	2.5	5.8	-6.8	-2.7
MSCI Japan	0.3	-1.7	-5.5	-5.3
MSCI AC Asia ex-Japan	0.8	6.9	3.8	11.5
MSCI Emerging Markets	1.1	6.2	3.0	11.8

Returns in Singapore dollars. Source: Bloomberg, 29 October 2010

Thanks to strong earnings performance, equity markets continued to post gains last month in spite of the mixed operating environment. For example, the MSCI AC World Index rose a further 3.5% in October on top of the 9% surge in October, measured in US dollar terms. All major regions are now in positive territory for the year.

The US mid-term elections witnessed a significant swing in favour of Republican candidates, who seized control of the House of Representatives from the Democrats. While the swing adds to near-term uncertainty as a lame duck government may not advance on key policy issues, the markets have interpreted the outcome as a positive for longer term policy. Meanwhile the UK government announced a significant fiscal belt tightening.

Another key development took place on November 3rd, when the Federal Reserve unveiled plans for Quantitative Easing 2 (QE2). Meanwhile, developed markets powered ahead supported by strong earnings performance underpinned by cost disciplines and margin gains.

On the economic front, growth has stabilised at lower levels as the US preliminary GDP prints show that 3Q growth could come in at 2%. This is up slightly from the 1.7% growth registered in the 2Q, but down from the 3.7% growth in 1Q. The growth outlook for 2011 remains muted with the developed world forecasts to register growth rate in the 2-3% range. Additionally, the developing world may start to see some downside risks to growth expectations, driven mainly by rising inflationary pressures.



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However, an issue that warrants a close look is the fiscal adjustment process that's being played out in Developed world. For example, UK budget cuts have the potential to destabilise the economy, while US fiscal policy is now in a state of flux. The fear is that a newly elected house of representatives will signal a renewed focus on fiscal restraint. For this reason, investors are now closely watching for signs of possible Bush tax cuts extension by the US administration and Congress. The hope that the US Congress can resolve the issue of the tax cuts before it goes into recess at the end of the year.

While it is important for the developed world to move towards greater fiscal consolidation, we are concerned that the entire process could be disorderly. Currently, Europe has adopted a hard nosed stance on revisiting its social pact with public sector workers; with French President Sarkozy lifting the retirement age in order to address longer term challenges without jeopardizing the short term outlook. The same hard-nosed political discussion will have to occur in the US at some point as well.

**OUTLOOK AND STRATEGY**

	Policy	Change	Comment
US	Underweight	–	The growth outlook for the US economy has turned decidedly more mixed. The employment and consumption data suggests that the overall growth trajectory for the US economy will likely be around a 2 handle rate into 2011, very weak given the extent of the downturn. The good news is that the US corporate sector, the S&P 500 in particular, is in excellent health. None-the-less, we have opted to reduce exposure given challenges on the domestic front and uncertainties on the policy front - Underweight.
Europe	Underweight	–	Leading indicators in Europe have rebounded sharply. And while consensus growth estimates are being raised, Europe will also be lucky to deliver a 2 handle rate growth into 2011. European unemployment has held up better than the US, largely due to the stronger core economies. The outlook for the more distressed parts of Europe remain bleak, and the contagion risk to the broader Eurozone through the currency union and banking system linkages is a real concern. We remain Underweight.
Asia (ex-Japan)	Overweight	–	Growth in Asia is moderating, but remains strong. China's tightening bias continues to pose longer term risks, as strong upward wage adjustments add to cost pressures. We remain more defensive, focused on sectors where pricing power should be stronger. As recent inflation data has shown signs of moderation, our bias toward domestic consumption driven economies was further reinforced. Overweight.



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, and will likely result in earnings downgrades. Corporate profitability still needs to recover further before we can justify further capital allocation. We are slightly Underweight.
Latin America	Overweight	↑	Latin America remains our preferred region, underpinned by strong domestic growth. Improved inflation data in Brazil brought an end to the tightening cycle. This is a significant positive for domestic demand and corporate earnings. The region continues to offer strong long term investment opportunities for equity investors. We remain Overweight.

In the Developed world, we see extended debt levels as a significant headwind. Household and public sector deleveraging will be a threat to growth and while we are hopeful that business investment will pick up, we do not believe that net export growth will be able to fully mitigate the domestic de-leveraging headwinds. Our investment strategy, with a bias towards companies that are positioned to sell into fast-growing Emerging markets, reflects this view.

Industrial activity in the Developed world has still not recovered to pre-crisis levels, and this raises question marks over the prospects for corporate investment spending. Other risks factors include the macro uncertainty in the UK and the Eurozone which are set to implement politically mandated budget reductions. Although expectations are for a cyclical rebound in corporate spending, we anticipate a downward bias to expectations.

Meanwhile, growth rates in the Emerging world have decelerated sharply, even though they remained well above the Developed levels. Recent data from China points to a moderation of fixed asset formation, while wage pressures remain acute. This could squeeze margins and profitability in the medium-term. Similarly, Brazil has registered a moderation in industrial output. We continue to focus on domestically driven growth opportunities within Emerging Markets. To gain leverage to the domestic demand growth of emerging markets we have turned to the most under-levered economies of Latin America, Africa, Eastern Europe, and Asia.

Still, it is worth noting that equity valuations remain very attractive despite the recent stock rallies. Many of the above-mentioned risks are already fully discounted by investors. Against a muted growth prospect, we continue to focus our attention on identifying the best growth opportunities for investors. This brings us back to Emerging markets. However, given the uncertainties over final demand, input costs, wages and taxes, we have moved decidedly up the quality curve.



### Contact Details

**Address** 80 Raffles Place UOB Plaza 2 Level 3 Singapore 048624  
**24-hour Hotline** 1800 222 2228 (Local) • (65) 6222 2228 (International)  
**Fax** (65) 6532 3868  
**Email** uobam@uobgroup.com  
**Website** uobam.com.sg

### Regional Offices

#### Singapore

Institutional Investments  
Dennis Siew  
Senior Director

Retail Investments  
Norman Wu  
Senior Director

Regional Investments  
Faizal M. Fazluddin  
Senior Director

Structured Investments  
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Vana Bulbon  
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