

QUARTERLY INVESTMENT STRATEGY

SECOND
QUARTER

2013

ASSET ALLOCATION

*Overweight Equities, Underweight
Bonds, Neutral on Commodities*

EQUITY STRATEGY

*Improved macro stability and
reduced event risks are more
supportive of risk assets*

FIXED INCOME STRATEGY

*Overweight Asian and Emerging
Market credits*

COMMODITIES

Growth in demand has eased



Staying the course

As one of the thought leaders in asset management, UOBAM regularly produces topical investment research articles and publications to help our clients stay on top of financial market developments.

Webcast – Asset Allocation Strategy for Q2 2013

In our quarterly webcast, Mr Tony Raza, Head of Multi Asset Strategy Unit, will share our asset allocation strategy, as well as discuss key issues driving developments in global markets.

View the webcast on the homepage of our website at uobam.com.sg.



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CIO MESSAGE

The first quarter of 2013 marked the fourth anniversary of the market lows of March 2009. The United States (US) Dow Jones Industrial Average index (Dow) has since more than doubled, surpassing previous highs. Markets are frequently described as “climbing a wall of worry”. With four years having passed since the depths of the crisis, the wall was indeed high. The more bearish market observers would point out that the recovery has only been achieved due to abnormally strong support from central banks. While there is truth in that observation, the reality is also that US corporate earnings and US Gross Domestic Product are at an all time high. Thus while the Dow is setting new highs, valuations are actually cheaper than before the crisis.

Yet, the first quarter was not a completely smooth one. The Italian elections raised concern over the cohesiveness of the Eurozone. Meanwhile, although the new government in China has shown renewed vigour in dealing with imbalances and pushed for reform, expansion in the world’s key growth economy has slowed.

The fact that peripheral European countries are growing tired of austerity should not be a surprise. What shook the markets was the inconclusive outcome along with the realisation that fringe parties are gaining influence and could potentially reject prior efforts to rein in public spending and debt. Divergence on the political front could presage a possibility of certain countries looking to quit the currency bloc.

The newly-established leadership in China appears intent on reforming the domestic economy even at the expense of growth. Prior rhetoric about the need for reforms has been backed up by action. The appointment of reformers to key leadership roles and moves to tighten lending for property have been undertaken despite economic data remaining on the weaker side of expectations. The new leadership seems to be reiterating a view espoused by the outgoing administration and that is that the quality of growth matters more than the level of growth.

The most positive development since late 2012 is the pickup in economic activity in the US. A recovery in housing data, firmer employment trends and a gradual pickup in industrial activity is starting to create a virtuous cycle of rising end demand. The shift in underlying trends in the US, accompanied by strong monetary stimulus, is starting to translate into leading indicators which continue to advance. Meanwhile, the global economy is facing fewer major threats and should remain on a path of steady progress.

We believe that this is a favourable environment for equities, especially stable growth stocks that can increase their dividends. Equity markets have done well for the past two quarters and we expect that they will continue to do well on the whole. However, as evidenced by diverging trends among companies, it is clear that the weaker growth backdrop is making stock selection more critical.

Geographically, we are most bullish on the US. A combination of macroeconomic factors and an abundance of attractive bottom-up investments is the key draw. The US corporate sector is in solid financial shape. Many of the leading businesses stand to benefit from the revival of domestic growth and a recovery of overseas demand.

While we continue to like emerging markets (Latin America and Asia), it is important to adopt a nuanced approach that differentiates between countries, sectors and companies. Not all trends are uniformly positive. In the emerging markets, it is imperative to identify sectors that will benefit from the shifting profile of growth. It is even more critical to pick the right stocks given the overcapacity and inflation pressures that persist in much of the emerging world.

Within fixed income, we continue to expect that Asian credits and Emerging Market credits in general will perform well on a risk-adjusted basis.

In this report, we publish our views, forecasts and recommendations over the next quarter. We hope that our investors will find the analysis in this report helpful in charting their investment calls ahead.



SUMMARY

Over the past quarter, equity markets saw a surge in capital inflows, even though fixed income funds continued to attract capital. Although the source of the fresh capital is as yet unclear, it is obvious that the fundamental picture has continued to improve. Furthermore, the sell-off in US Treasuries coupled with the low implied volatility in the options market suggests that the fear factor is easing.

US Treasury yields are rising. The 10-year Treasury yield has increased over 15 basis points to about 1.87 per cent since the start of the year. That has spurred talk of 10-year rates rising to as high as 2.5 per cent this year, if not close to three per cent. That the treasury yields should eventually normalise is not in doubt, since the US economy has shown steady improvement for the past year. However, we believe in a gradual rise, rather than a spike in rates.

US budget sequestration should not derail economy. We expect both direct and indirect effects as a result of the scheduled cuts. The direct channel comes from the cut in federal and local government spending, which feeds directly into gross domestic product (GDP). The second channel includes reduced personal consumption as cuts in federal personal salaries weigh on personal income growth.

However, even with the negative effects, we do not expect the budget sequestration process to derail the modest pickup in GDP over the next couple of years.

The gold puzzle? It is odd that gold has been shedding its shine, despite an accommodative monetary stance. If anything, it should continue to rise in an environment of rising inflation. Instead, we have seen the opposite occur since the US Federal Reserve launched its open ended round of quantitative easing.

Several explanations have been offered, but none can explain all the recent price actions in the foreign exchange, credit spreads and gold market. What is clear though is that this is an issue that will probably continue to dog the investment community in the next few months.

Overall, we see a better mix of factors and therefore, recommend overweight in risk assets. We see better macroeconomic data, with attractive equity valuations and potential policy support. Within equities, we still prefer emerging Asia over developed markets, and favour high quality counters that are trading at attractive valuations. Within fixed income, we prefer emerging markets over developed markets, and favour investment grade credits over high yield credits.

ASSET ALLOCATION

	2Q13 Policy	UOBAM weight (%)	Benchmark weight (%)	Change from 1Q13
Equities	Overweight	65.0	55.0	=
Bonds	Underweight	29.0	38.0	=
Commodities	Neutral	5.0	5.0	=
Cash	Underweight	1.0	2.0	=

The improved macro backdrop and recovery in risk appetite make the current environment a more conducive one for investors.

It is clear to us that there is greater stability on the macroeconomic front with improving growth prospects. Furthermore, we note that investors' risk appetite is recovering slowly, judging from the inflows into more risky emerging markets local currency issues and high yield bonds.

In view of the above, an asset allocation strategy with a bias toward "risk assets" (such as equities and corporate credits) may be warranted. For this reason, we maintain the following calls:

Equities – Overweight

Improved macro stability and reduced event risks are more supportive of risk assets.

Fixed Income – Underweight

Global fund flows are more balanced, with increasing flows toward equities and slowing flows toward bonds. We overweight Asian and Emerging Market credits but underweight government bonds as we still see some potential for spread compression.

Commodities – Neutral

While the macroeconomic backdrop has improved, we note that the growth in demand for commodities has eased. Furthermore, the economic data appear mixed overall. For this reason, we stay neutral.

SECOND QUARTER INVESTMENT TRENDS

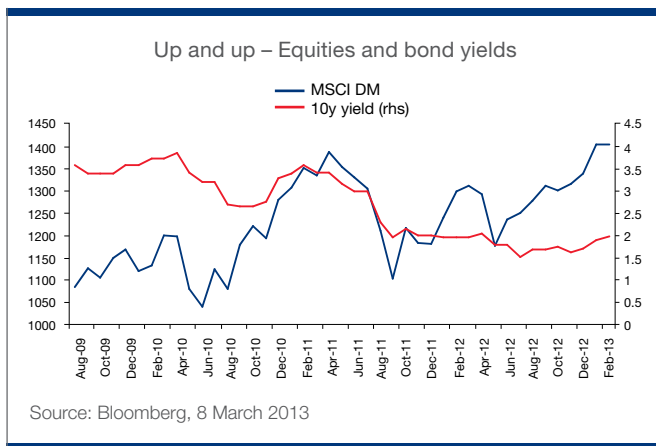
Last quarter, we wrote about a possible reallocation from bonds into equities while the global macroeconomic environment stabilised. Since then, equity markets have seen a surge in capital inflows, even though fixed income funds continue to attract capital.

Although the source of the fresh capital is as yet unclear, it is obvious that the fundamental picture has continued to improve. Furthermore, the sell-off in US Treasuries coupled with the low implied volatility in the options market suggests that the fear factor is easing.

In the following sections, we will explain the reasons underpinning our constructive views and our investment ideas over the quarter.

1. The modest rotation

Last quarter, we held out the possibility that the four-year rally in bonds may be coming to a close, and that equities may be due for a sustained rally. Since then, the equity markets have seen greater inflows of funds than the bond markets. Current market pricing certainly suggests that a corner has been turned. For example, the MSCI's developed market equities index has clocked up over four per cent since the start of the year, while US and German government bonds slipped into the red.



Investors' preference for stocks in 2013 is also undisputed. In the first five weeks of the year, about US\$70 billion of monies flowed into equity mutual and exchange-traded funds, which are often seen as a proxy for retail or household savings activity. That surpassed the previous historic peak in 2000, and is more than three times the US\$23 billion of inflows seen for the whole of 2012.

While we are encouraged by these positive developments, we acknowledge that it is unclear at this moment if these are truly the green shoots of the 'Great Rotation'. This is partly because the fixed income market has also attracted hefty inflows this year, even if the demand has been less than that for stocks.

Furthermore, some market analysts have pointed out that the source of new monies appears to be cash reserves or deposits, and therefore, the rally really reflects retail investors redeploying their surplus cash into stocks and bonds alike. In this case, the sustainability of the rally is in question, even though the improved macroeconomic backdrop should, in principle, support continued buying activity.

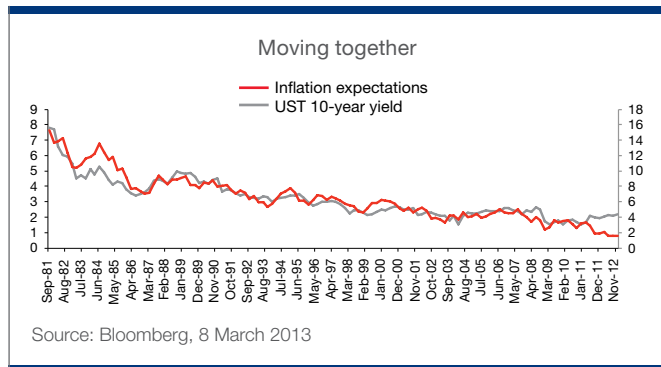
2. Where is the 10-year yield heading?

The US government bond yields appear to be finally heading higher on perceptions of an improving economy and lower chances of a fiscal crisis. The 10-year Treasury yield has increased over 15 basis points to about 1.87 percent since the start of the year. That has spurred talk of 10-year rates rising to as high as 2.5 per cent this year, if not close to three per cent.

In our view, that treasury yields should eventually normalise is not in doubt, since the US economy has shown steady improvement for the past year. By itself, it should raise growth expectations and real rates, and finally the nominal interest rates as well.

However, we do not believe that the 10-year yield will spike up to a high of close to three per cent. To us, a level of 2.25 per cent or an upper boundary of 2.5 per cent for the US 10-year yield appears to be a more likely scenario for the following reasons.

Firstly, the level of the yield curve (as proxied by the US 10-year rate) depends largely on inflation, both theoretically and empirically. A quick estimate of the correlation between US core CPI inflation and 10-year rate puts it at over 90 per cent. Our internal model, which replaces current inflation with inflation expectations (data from Survey of Professional Forecasters), found a similarly strong relationship between the two.



Our view is that US core inflation and price expectations will rise gradually (and not a spike). Therefore, a gradual rise in the US 10-year rate appears to be a more likely scenario, if the statistical relationship continues to hold.

Besides, the Federal Reserve's open ended quantitative easing program is expected to continue until early next year at least, and that provides an implicit cap on the US interest rates. For this reason, we believe that a cap of 2.5 per cent on the 10-year rate is a more likely outcome.

3. Fiscal improvements in the US

Starting in the first quarter of 2013, the US has started on a more proactive effort to reduce its deficits. At the beginning of the year, tax rates for the wealthy were returned to Clinton-era levels and the payroll tax that affects the lower to mid income level workers was raised by two per cent. Starting 1 March, spending cuts known as the sequester took effect as well. All together, the austerity measures in the US in 2013 are expected to reduce GDP growth by about 1.5 per cent. Nevertheless, there is enough evidence of underlying economic growth being strong enough to withstand the austerity and thus being able to maintain overall GDP growth level at around two per cent.

The US Congressional Budget Office has indicated that the US deficit has already fallen from 10 per cent of GDP to 6.7 per cent as of end February, with forecasts for it to drop further to 3.5 per cent by 2014 and 2.4 per cent by 2015. At those levels, the overall levels of debt to GDP should start to decline (due to the denominator of nominal GDP growing faster than the debt levels). The US appears to be getting closer to establishing that it has enough economic traction to reduce its deficits and maintain growth at the same time. If so, confidence in the US fiscal situation will improve rapidly and most likely be supportive to the US dollar.

Currently, our view is that the US economy should continue to grow, albeit at low levels, as the housing market continues to recover. Furthermore, there are improvements in terms of payroll and unemployment, and we expect these to filter through to real disposable income. As current spending depends to a large extent on current and expected future disposable income, the improvements should help support consumption spending.

Admittedly, there are concerns that budget sequestration can potentially push the US economy into a fresh patch of weakness. In fact, we expect both direct and indirect effects as a result of the scheduled cuts. The direct channel comes from the cut in federal and local government spending, which feeds directly into GDP. The second channel includes reduced personal consumption as cuts in federal personal salaries weigh on personal income growth.

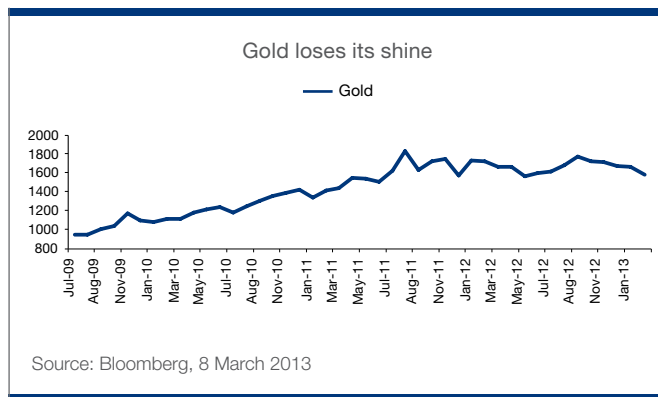
The US political situation remains messy. In a positive light, it should be noted that the Democrats and Republicans are quite close to a fiscal compromise that will stabilise its long term debt levels, and which involves entitlement reform and closing tax loopholes for the wealthy. But given the history of US politics, it is usually prudent not to expect the best. In a negative light, there are also upcoming issues such as the continuing resolution and the debt ceiling extension, which could have negative economic consequences if politicians fail to come to any compromises.

4. Gold loses its shine

One of the puzzling developments over the past two quarters has been gold losing its shine. From September 2012 till now, the price of the precious metal has fallen 10 per cent to US\$1581 per ounce, despite the Federal Reserve’s open ended quantitative easing program.

Why is this puzzling? For one, an accommodative monetary stance should be good for risk assets and commodities. Second, gold is often seen as a good inflation hedge. Therefore, as inflation expectations rise along with the amount of liquidity in the system, gold price should be lifted further.

However, we have seen the opposite since Bernanke’s (QE3) speech in the third quarter last year, while the euro started to recover.



One explanation that has been put forward is that the market is pricing in the “end” of the euro crisis, and re-rating assets accordingly. The problem with this explanation is that credit default swap spreads have lately started to widen again, and Italian and Spanish banks have started to underperform again.

Another explanation is that there is a “black hole” in the banking system somewhere in Europe, and whoever is sitting in this black hole is trying to borrow US dollars and to sell gold. The problem with this explanation is: Why would gold be the only asset class suffering from selling pressure? Why not European stocks?

In short, the recent price actions in gold and other currencies have thrown up questions about what is happening in the financial markets. Could gold be the proverbial “canary in the gold mine” telling us that something is not quite right? No matter what, this is an issue that will probably continue to dog the investment community in the next few months.

5. Assessment

In summary, the global economic backdrop has shown signs of improvement, but we have to remain vigilant. We believe the US budget sequestration issue will be resolved, even though it may take a little longer for both camps to hammer out a deal. Also, our view is that the effect of the spending cuts on the GDP trajectory will not be severe enough to trigger another recession.

In Europe, the recent stalemate in the Italian elections has held out the prospects of a hung parliament and weighed on sentiment. We acknowledge these concerns, but believe that the European Central Bank’s commitment “to do whatever it takes” to support the euro provides an implicit floor for how bad things can go. Certainly, the different camps are now more willing to compromise on the way forward, and that should be assuring for the investment community. Additionally, the China economy has turned the corner as exports and manufacturing orders recovered.

Against this backdrop, we recommend an overweight in equities on the back of increased stability on the global macro front. Meanwhile, valuations appear attractive, and this presents an attractive risk-reward proposition for equity investors. Within equities, we prefer the US, Asia and Latin America. Countries that we are cautious on include Europe, Japan, Australia and Canada.

Within fixed income, we favour corporate credits over government bonds. Emerging markets credits are still preferred over developed market bonds.

GLOBAL
EQUITY
STRATEGY

Equities Overview

Equities				
Asset Allocation	2Q13 Policy	UOBAM weight (%)	Benchmark weight (%)	Change from 1Q13
US	Overweight	50.5	46.4	↓
Europe	Underweight	19.0	24.0	↑
Asia ex-Japan	Overweight	12.0	9.5	↑
Japan	Underweight	5.0	7.6	↓
Canada	Underweight	2.5	4.1	↓
Australia	Underweight	1.5	3.5	↓
Latin America	Overweight	7.0	2.7	↑
EMEA*	Neutral	2.5	2.2	↑

* EMEA - Europe, Middle East and Africa

The global macroeconomic climate has stabilised. Fears of the United States (US) going over the fiscal cliff have receded, and the US housing market is showing signs of a strong recovery. We are still cautious on Europe, as the debt crisis remains unresolved. Furthermore, the stalemate in the Italian elections has introduced fresh political uncertainty – a development which is generally not positive for the markets.

The **US** economy is showing signs of improvement. This is especially the case for household consumption and investments. The US housing market is clearly improving, as seen from the builders' confidence surveys. In terms of household balance sheets, the US enjoys lower household debt relative to its peers, and the shale gas discovery is a structurally positive development for the country.

In **Europe**, most countries are still in contraction mode, as the Purchasing Managers' Index (PMI) hovered below 50. Furthermore, credit recovery remains lacklustre, and the private debt to GDP ratio is still high by historical standards. Therefore, there is still much deleveraging ahead for Europe.

In **Japan**, debt relative to GDP is still an issue, while the country grapples with a serious demographic challenge. Furthermore, Japanese corporations are losing their market shares. These are reasons behind our underweight in Japan.

We continue to be overweight on **Asia ex Japan**, as the region is expected to fare better than the developed world. However, we note that the growth is slowing, and therefore, we will focus on structural opportunities and on companies with strong cash flow.

We continue to like **Latin America** as its long term structural growth story remains intact. This is partly underpinned by domestic demand and expansion in household borrowings.

US

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Overweight	13.0	12.1	↑	Home Depot
Consumer Staples	Neutral	10.5	10.7	↓	Brown Forman
Energy	Neutral	11.0	11.1	=	Exxon Mobil
Financials	Overweight	16.5	15.6	=	Visa
Healthcare	Neutral	12.0	12.1	↓	Gilead Sciences
Industrials	Overweight	12.0	10.3	↑	Eaton
Materials	Underweight	3.0	3.5	↓	Tornox
Technology	Underweight	17.5	18.3	↓	Qualcomm
Telecommunication	Neutral	3.0	3.0	=	DirectTV
Utilities	Underweight	1.5	3.4	=	Southern Company

Benchmark: MSCI USA

We are constructive on the US market as investors and businesses alike are looking past the fiscal cliff issues to focus on their businesses. Economic activity which had originally been supported only by housing, is broadening out. Related activities such as employment and lending are supportive.

General capital spending currently indicates that spending is moving beyond the replacement cycle to an investment cycle. In fact, the latest uptick in US core durable goods orders of 6.3 per cent suggests business spending is picking up after decelerating in 2011 and 2012. While it is possible that parts of the US economy such as government spending continue to feel the impact from the cutback in fiscal spending, there is a high chance now that other areas of the economy such as capital spending may fill the gap.

Business spending has turned the corner. Businesses finally seem to be expanding capital spending beyond replacement needs, reflecting the improvement in economic conditions. Net capital spending as a share of GDP, or new capital spending demand, which typically lags the business cycle, rose to a latest reading of 4.1 per cent, from a low of 2.4 per cent in 2011. The manufacturing recovery lost some of its momentum in 2012, as the ISM Manufacturing Index declined to 50.2 in Q4, matching its lowest quarterly level since Q2 2009. We expect manufacturing growth to continue at a moderate pace in 2013, driven by pent-up demand for housing, vehicles, other durable goods, and energy infrastructure.



In terms of corporate earnings, the earnings surprises index and profit guidance have improved since the start of the year. We expect S&P 500 earnings to reach US\$107 in 2013, representing four per cent earnings per share (EPS) growth over 2012. The estimate reflects the fairly stable 2012 GDP growth forecasts of between 2 – 2.5 per cent, increasingly favourable cyclical tailwinds from a stabilising housing and lending market - offset by headwinds from a financially weak Europe. Based on the EPS estimate, our discount model estimates a S&P500 fair value of 1700, or close to 10 per cent upside from here. Relative to the last quarter, we have reduced our risk premium from 6.3 per cent (a 50 per cent premium to the historical average of 4.5 per cent) to 5.6 per cent (or a 25 per cent premium).

The upside risk to our valuation target lies in the discount rate. Given that the current environment remains sensitive to macroeconomic and political risks, the valuation is extremely sensitive to a change in risk premium. For example, a decrease of equity risk premium by one per cent increases the fair value by about 13 per cent. Translating this to multiple valuations, a target of 1700 implies a 15x 2013 price-earnings ratio (P/E). Barring a meltdown in the financial markets, this valuation is attractive given the potential for further upward earnings revisions and growth as we head into the year end.

Meanwhile, the volatility has presented buying opportunities for stocks that we like. One of the themes we like concerns the growing Hispanic population. Some 20 years ago, the immigration laws in the US were relaxed and that brought a wave of Hispanic migration to the US. Now, the children of these immigrants, are entering the workforce. Today, almost one in six Americans is of Hispanic descent, and this ratio will continue to rise even as immigration slows. This population is expected to increase by 32 per cent over the next 10 years to 19 per cent of the population, up from an estimated 49.3 million and 15.9 per cent in 2010. Based on some of these trends, we like “Do It Yourself”-oriented retailers such as home improvement and auto part retailers (e.g. Home Depot, Lowes, Auto zone) that should benefit from the rapid growth of this demographic group.

Meanwhile, the average Hispanic household income of less than US\$40,000 would make the group part of the natural target market of the “dollar” stores or the small box value retail stores (e.g. Dollar General, Dollar Tree and Family Dollar Stores). As California accounts for 28 per cent of the total Hispanic population and these retailers are relatively underpenetrated in this state, there are ample growth opportunities for these companies.

Beverage companies with wide innovative offerings ranging from the spirits, wine, aperitifs, tequilas to flavored sodas (e.g. Diageo, Campari) are known to have benefited, as this younger generation enjoy experimenting and are open to different tastes.

EUROPE

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Neutral	9.0	9.1	=	WPP Group
Consumer Staples	Neutral	15.0	14.9	↓	Henkel AG
Energy	Overweight	10.5	10.0	↓	Tullow Oil
Financials	Underweight	20.0	20.8	↑	HSBC Holdings
Healthcare	Overweight	13.0	12.3	=	Coloplast A/S
Industrials	Neutral	11.5	11.4	↑	Assa Abloy
Materials	Neutral	9.0	9.3	=	Rio Tinto
Technology	Overweight	4.5	3.1	↓	Gemalto
Telecommunication	Underweight	4.0	5.2	↓	Millicom International Cellular
Utilities	Underweight	3.5	3.9	=	United Utilities Group

Benchmark: MSCI Europe

We are maintaining our underweight position in European equity markets. Although market performance has been positive in recent months, this is largely due to the continued ability of the European Central Bank (ECB) and other European institutions to lower sovereign debt yields and reduce the risk of a Eurozone break-up. Actual underlying economic performance remains weak, with negative GDP growth in a number of countries. Banks are reducing lending to both the corporate and consumer sectors, and companies are struggling to grow revenues. Inevitably, this has produced further downgrades to 2013 company earnings forecasts.

Investors are most concerned with developments in Italy, Spain and France - the three most important countries in the Eurozone after Germany. Italy has generated the largest number of headlines in recent weeks following national elections that failed to produce a workable government. There is now a risk that further elections will be needed in the second half of 2013, with no unified government in the interim. A failure to adhere to the austerity measures

and supply side reforms of the previous Monti government could see a renewed spike in Italian bond yields, and force the country to apply to the European Stability Mechanism for support in the primary sovereign debt market. In turn, this would allow the ECB to use its Outright Monetary Transactions (OMT) programme for support in the secondary market.

In Spain, attempts to stabilise the banking sector may be undermined by continued declines in the housing sector. Latest industry data shows that domestic house prices are declining at 15 per cent year-on-year (y-o-y), the fastest rate of decline since the 2008 financial crisis. Manufacturing and services PMI readings remain firmly in contraction mode, with unemployment at record levels. The Rajoy government has become embroiled in a bribery scandal, with polls showing a sharp decline in political support. This will make it difficult for the country to force through the austerity and supply side reforms supported by the European Commission.

France had been a relatively strong Eurozone performer in 2012, but recent economic data points to a worrying downturn. Recent manufacturing and services PMI readings are in the low 40.0s, signaling a contraction in economic activity. Unemployment levels are rising, house prices are softening, and construction activity is dropping sharply. Noticeably, the gap between Germany and French PMI readings is at the widest level in almost 17 years. This indicates that France might begin to be categorised with the peripheral Eurozone economies, rather than the stronger Northern European countries. President Hollande's approval rating has dropped sharply over the past year, even before he has taken significant action to cut France's fiscal deficit.

The poor macroeconomic environment is having an impact on the performance of European companies. Weak economic activity continues to limit revenue growth and puts pressure on operating margins. Sell-side analysts have steadily downgraded 2013 earnings forecasts, and we expect further downgrades throughout the year. The poor earnings environment means that we remain with our defensive investment approach. We continue to focus on value companies (high ROEs, consistent growth), companies with a high degree of export sales, and companies that have a high, sustainable dividend yield.

In terms of sector allocation, we are overweight the energy, healthcare and technology sectors. We are underweight the financials, telecommunications and utilities sectors. We are neutral on the consumer discretionary, consumer staples, basic materials and industrials sectors.

Our greatest overweight remains the technology sector. We are positioned for structural growth trends in smartphones and in increased mobile payments. We are avoiding commoditised component suppliers. The healthcare sector should benefit from structural shifts in different national healthcare markets and provide defensive qualities through solid dividend payments. Certain companies within the energy sector also provide attractive dividend yields.

We have significantly reduced our underweight position in the financials sector. European banks continue to restructure and to report low aggregate loan growth. However, the obvious intent of the ECB to support the banking system means that the more negative tail risks appear contained for the time being. We remain underweight the utilities sector due to generally high debt levels and regulatory risk. We have moved to an underweight position in the telecoms sector due to concerns of higher capital expenditure requirements that may not be supported by revenue growth.

ASIA EX-JAPAN

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Overweight	14.5	9.2	↑	Galaxy Entertainment
Consumer Staples	Overweight	9.0	5.4	↓	ITC
Energy	Underweight	5.5	7.0	↑	China Coal Energy
Financials	Neutral	25.5	25.8	↑	China Life
Real Estate	Underweight	6.0	7.5	=	Cheung Kong
Healthcare	Overweight	2.0	1.1	=	Bangkok Dusit Medical
Industrials	Underweight	8.0	9.2	↓	Hyundai E&C
Materials	Underweight	4.0	6.4	↑	Semen Gresik
Technology	Underweight	17.5	18.4	↓	AAC Tech
Telecommunication	Underweight	4.5	6.3	↓	Telekomunikasi Indonesia
Utilities	Neutral	3.5	3.8	↓	Perusahaan Gas Negara

Benchmark: MSCI AC Asia ex-Japan

The structural backdrop for Asia remains one of slower growth in the developed world and our strategy is to remain focused on structural opportunities and companies that generate strong cash flows and pay out sustainable high dividends. Valuations remain supportive of a continued re-rating of the market, and earnings expectations – having been moderated over the past year – could well surprise on the upside.

In addition to the quality growth style approach in our stock selection, we have adopted a tactical positioning in 2Q13 to focus on the ASEAN markets, investment implications from China's recently concluded National People's Congress (NPC) and opportunities arising from China's efforts to 'go green'.

The economic momentum in the Southeast Asian markets of Thailand, Indonesia and the Philippines has been better than expected. We have raised our overweight position and find opportunities in the consumer, banks, real estate and healthcare sectors. Within the consumer sector for example, retail sales have been growing at close to 20 per cent y-o-y in these economies, driven by a growing and increasingly affluent middle class population. The ASEAN economies are also benefiting from an inflow of foreign direct investment, particularly from Japanese companies looking to diversify beyond China. The cost competitiveness of industrial land prices in Thailand and Indonesia compared with those of key Chinese cities, as well as the lower wages of Jakarta, Bangkok, Manila and Kuala Lumpur workers compared with those in Beijing, have increased the attractiveness of the region to investors.

The recently concluded NPC in China presents some investment opportunities. With the government's focus on curbing overcapacity, industry leaders in the cement, steel and automobile sectors should benefit from subsequent consolidation. Urbanisation and land reforms will likely benefit train manufacturers and social housing players. Financial reforms by way of interest rate liberalisation, opening up of the domestic stock markets as well as a resumption of IPOs will benefit brokers and insurers.

China's focus on pollution control by promoting clean energy (gas, wind and solar) will benefit gas distribution and services as well as the renewable energy sector. With the policy target of raising gas energy consumption by a compound annual growth rate of 18 per cent between 2011 to 2015, local governments will be pushing out intra-provincial gas transmission build-out. Companies involved in the supply of gas throughout the nation will likely benefit from this trend.

The structural growth opportunities in Asia remain underpinned by rising consumer affluence, a huge population and favourable demographics. Valuations remain supportive, at below mean levels. We favour quality companies in industries with secular growth trends and high and growing dividend yield.

JAPAN

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Overweight	22.0	20.9	↑	Nissan
Consumer Staples	Neutral	6.5	6.3	↓	Sundrug
Energy	Neutral	1.5	1.5	=	Inpex
Financials	Neutral	15.5	15.8	=	Bank of Yokohama
Healthcare	Neutral	6.5	6.9	=	Sawai Pharmaceutical
Industrials	Overweight	20.5	19.7	↑	Makita
Materials	Underweight	5.5	6.7	=	JSR
Property	Neutral	5.0	4.6	=	Mitsubishi Estate
Technology	Neutral	11.0	10.8	=	Hitachi
Telecommunication	Neutral	4.0	4.3	=	NTT DoCoMo
Utilities	Underweight	2.0	2.6	=	Tokyo Gas

Benchmark: MSCI Japan

Since the start of the year, Japanese equities have risen strongly, buoyed by optimism over the new government's reflation policies and sharp weakening of the Yen. A near-term correction cannot be ruled out, given the rapid rise over the last two to three months. However, as Japanese equities are still under-owned, and the backdrop has clearly improved, we think share prices may stay firm in the next few months.

The major events to watch for over the next few months include the Bank of Japan (BoJ)'s monetary policy meeting under its new leadership in April, the announcement of the Japanese government's growth strategies in June, and the Upper House Election in July.

We expect the new central bank administration to discuss bold measures that could involve increased asset purchasing, centering on government bonds (JGBs), and buying longer maturity JGBs. It may also bring forward open-ended asset purchases to 2013 and extend the type and size of risk assets purchased.

All eyes will also be on the details of the government growth strategies which could include participation in the Trans-Pacific Partnership (TPP) - a pillar of the government's growth strategy, tax reforms (including corporate tax cuts), and regulatory reforms. Lastly, the Upper House elections will be watched closely. Going by the rising popularity rating of the Abe administration, there are now increased expectations that the LDP will win the upcoming elections and do away with the split parliament, thereby clearing the path for "Abenomics".

As for the global economy, there are growing signs of a recovery based on the improvements in global PMIs. Japan's PMI has similarly rebounded. In February, the PMI rose for the second consecutive month, rising by 0.8 points to 48.5. Japan's real GDP growth is expected to recover in the upcoming quarters, helped by a gradual recovery in consumption and exports, as well as the 13 trillion yen fiscal stimulus. Furthermore, Japan's earnings revision momentum has improved, thanks to weakness in the Yen.

Our preference remains the exporters. As long as the BoJ maintains its aggressive monetary easing stance, we expect the Yen to stay weak, thereby providing a tailwind for earnings of the export-oriented companies.

We are overweight the consumer discretionary and industrials sectors, neutral the consumer staples, financials, telecommunications, energy, and technology sectors, and underweight the materials and utilities sectors.

The longer term growth trajectory will continue to be influenced by developments in Europe and the US, where there are still some headwinds. As such, we remain highly selective and target those companies with better earnings visibility and relatively healthy balance sheets.

CANADA

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Overweight	7.0	4.3	=	Tim Hortons
Consumer Staples	Underweight	-	3.0	=	-
Energy	Neutral	26.0	26.0	↑	Pacific Rubiales Energy
Basic Materials	Overweight	18.5	16.4	↓	Agrico Eagle
Financials	Underweight	31.5	35.5	=	Bank of Nova Scotia
Healthcare	Underweight	-	2.4	=	-
Industrials	Overweight	17.0	7.0	↑	Kansas City Southern
Technology	Underweight	-	1.2	=	-
Telecommunications	Underweight	-	3.1	=	-
Utilities	Underweight	-	1.1	↑	-

Benchmark: MSCI Canada

We remain underweight on Canadian equities, as we prefer investing in a North American economic recovery through the more broad-based US stock markets. This has been the appropriate strategy in recent quarters, with the Canadian equity markets under-performing domestic US equity markets. Canada remains reliant on the US economy for its export growth, although recent data indicates that Mexico is gaining US export market share at the expense of Canada.

Although FY13 GDP forecasts for the Canadian economy are generally above two per cent, consensus GDP forecasts for the US economy are slightly stronger, with the US also having lower inflation forecasts and a faster decline in unemployment rates. This is indicative of the current positive trends in US home sales, construction activity and home prices. In contrast, Canadian home prices and resale activity are flat at best, and construction activity has been in sharp decline for almost six months. The Canadian housing market appears to be having a negative impact on consumers, with consumer loan growth weakening to 4.8 per cent in early 2013. This continues the downward trend in consumer loan growth that was evident throughout 2012.

Canadian resource companies can be expected to benefit from stronger growth in both the US and Chinese economies. Although the global monetary conditions remain supportive, it is still uncertain if this has produced sustainable growth in the world's two largest economies. Commodity prices remain range-bound, with investors watching for signs of economic strength post the Chinese New Year. Gold companies are an important component of the Canadian resource sector, and these companies continue to de-rate on expectations of a future rise in interest rates. It appears appropriate to have a neutral weighting on commodity-related sectors until there is a clearer trend in global demand.

From a sector perspective, we have moved to an overweight position for the industrial sector by the addition of Canadian Pacific Railway. Along with their US counterparts, Canadian railway stocks are seeing strong traffic volumes based on increased energy and foodstuff transportation. We have funded this position by neutralising our sector weights in the energy and basic materials sectors, both overweight previously. Continued weakness in the Canadian housing sector means that the financial sector remains vulnerable to negative news-flow. As noted before, the sector appears to have modest potential for earnings growth and valuation expansion.

AUSTRALIA

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Underweight	0.0	1.7	=	-
Consumer Staples	Overweight	11.5	9.2	=	Woolworths
Energy	Overweight	8.5	5.9	↓	Oilsearch
Financials	Underweight	44.0	48.3	=	ANZ
Healthcare	Overweight	7.5	4.2	=	Ramsey Health care
Industrials	Underweight	0.0	4.6	=	-
Materials	Neutral	22.5	22.1	=	BHP
Telecommunication	Overweight	6.0	2.5	↑	Telstra
Utilities	Underweight	0.0	1.5	=	-

Benchmark: MSCI Australia

The Australian stock market continued to perform strongly, with the ASX200 crossing the 5,000 level. Improved global economic conditions, particularly from China and the US, coupled with increased confidence levels, helped to lift the stock market's performance. Meanwhile, the recent reporting season saw better than expected results, with "beats" surpassing "misses", and aggregate earnings forecasts holding steady. A reprieve on profit margins was the key theme as companies focused on cost cutting in the presence of weak top-line growth. Companies also raised payout ratios, resulting in dividends being upgraded more than earnings. Given that corporate balance sheets are still quite healthy, further capital management is possible.

With earnings remaining relatively flat and the market continuing its upward trajectory, the market is now trading on 14.4x price-earnings ratio (P/E) on a 12-month forward basis, equivalent to a 17 per cent premium to the historical five-year average. We suspect conditions in the second half of the year could prove to be challenging, on the back of anaemic domestic economic conditions and constraints on growth that continue to impinge on Australian businesses.

Taking the above into account, we are focussed on quality growth and quality income. We remain cautious about domestic cyclicals as households continue to deleverage and unemployment is expected to rise and confidence to remain low. At the same time, we attempt to leverage on yield compression plays through high quality banks, REITs and consumer staples, on expectation of further rate cuts.

Overall, we maintain our cautious stance but intend to add modest cyclical bias opportunistically. The materials sector remains captive to uncertainty surrounding China, and any shift to pro-stimulus policies will boost the sector. Meanwhile, we take comfort in China's PMI maintaining above the 50 threshold, suggesting that the Chinese economy has bottomed out, at least in the near term. On the whole we are overweight sectors such as consumer staples, healthcare, energy and telecommunications, and underweight sectors such as consumer discretionary, financials, industrials and utilities.

LATIN AMERICA

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Overweight	14.0	5.3	↑	Cia Hering
Consumer Staples	Underweight	14.0	18.6	↑	Ambev
Energy	Underweight	7.0	10.9	↓	Pacific Rubiales
Financials	Overweight	27.0	24.7	↑	Itau
Healthcare	Underweight	0.0	0.8	=	-
Industrials	Overweight	9.0	5.6	=	Marco Polo
Materials	Underweight	17.0	19.5	↑	Vale
Technology	Underweight	0.0	1.4	=	-
Telecommunication	Neutral	7.0	7.0	↓	America Movil
Utilities	Underweight	5.0	6.1	↓	AGUAS 'A'

Benchmark: MSCI Latin America

We remain positive on the Latin America (LatAm) markets as we believe that the secular growth story remains intact, while the corporate earnings outlook is resilient. Our investment strategy is to adopt a defensive positioning within domestic plays.

For 2013, LatAm's GDP is forecast to grow about four per cent, largely driven by the peripheral countries such as Chile, Columbia and Peru. With the exception of Brazil, inflationary pressures are moderating across most of the LatAm markets. Meanwhile, employment continues to be very strong with low unemployment rates and the growing work population has given rise to strong income growth in the region. This bodes well for the domestic consumption story.

The fiscal balances of most LatAm countries are still strong and the central bank interest rates for most countries are now back to a neutral rate, except for Brazil (where we are underweight) where the policy rate is at all time low. This provides the central banks with monetary policies to use as a tool to stimulate the economy in an event of any global slowdown.

LatAm stocks are currently fairly valued in our view, with the market trading at 12.9x consensus forward price-to-earnings, a 26 per cent premium against the historical average of 10.2x. Earnings revisions have since troughed and we are expecting positive revisions moving forward, in line with global economic growth.

The key risks are inflation, political instability and a global economic downturn. Recent data have shown inflationary pressures picking up in Brazil, even though the headline figure is still way off previous peaks. We continue to expect the tight labour market and wage inflation to be an issue.

We view that the long-term structural growth story of the LatAm economies remains intact, underpinned by the strong domestic demand and underleveraged population. Our strategy is to add to our positions on dips, with a preference for domestic cyclical sectors. We are overweight the financials, industrials and consumer discretionary sectors and underweight the consumer staples, energy and materials sectors.

SPECIALIST
EQUITY
STRATEGY

CHINA

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Overweight	8.5	5.1	↑	Haier Electronics
Consumer Staples	Underweight	3.5	5.3	↓	Hengan International
Energy	Overweight	17.5	16.8	↑	Anton Oilfield Services
Financials	Underweight	30.5	33.6	↑	China Life Insurance
Real Estate	Underweight	5.5	6.2	=	China Resources Land
Healthcare	Overweight	1.5	0.9	=	Sinopharm
Industrials	Underweight	5.0	6.4	↓	CSR Corp
Materials	Neutral	5.0	4.5	=	CNBM
Technology	Overweight	7.0	6.6	↓	AAC Technologies
Telecommunication	Underweight	10.0	11.5	↓	China Mobile
Utilities	Overweight	6.0	3.3	↑	China Resources Gas

Benchmark: MSCI China

The macroeconomic data as of end February has continued to show a stabilisation in the Chinese economy, although the rate of improvement that we saw in the fourth quarter of 2012 has somewhat moderated. After seeing a strong pick-up, the PMIs since October 2012 have moderated in February 2013 but still stayed above the 50 expansionary mark. Meanwhile, other high frequency data have also moderated. Industrial production declined to 9.9 per cent y-o-y for January to February 2013, down from 10.3 per cent y-o-y in December 2012. Retail sales grew 12.3 per cent y-o-y for January to February 2013, down from 15.2 per cent y-o-y for December 2012, probably impacted by the government's campaign against corruption and lavish spending. For instance, revenue for large catering firms fell 3.3 per cent y-o-y in the January to February 2013 period, compared with a 14 per cent increase a year ago. On the other hand, fixed asset investment growth accelerated to 21.2 per cent over the same period, up from 20.6 per cent y-o-y for 2012. This was likely a result of additional infrastructure construction

activity as local governments catch up on projects that were meant to have been built during the first half of 2012. We had earlier postulated that the economic recovery would likely carry through this year but would be mild, so that view looks to be panning out so far.

Despite a healthy backdrop of macroeconomic data, channel checks on corporate profits are still pointing to on-going challenges in the face of slower growth. China will see structurally lower growth going forward compared to its historical norm as it transitions into a more balanced growth model. This will place pressure on corporate profitability in the near to medium term given lingering overcapacity, cost pressures from rising labour costs and weaker end market demand, especially from overseas. The challenge is for the government to pursue reforms that will improve the structure and competitiveness of the economy and the corporate sector.

The recent National People's Congress highlights the government's focus on improving quality and distribution in the economy, while de-emphasising the pace of growth. Lower monetary growth targets have been set, together with more property controls such as price appreciation guidelines, enforcement of capital gains tax and wider roll-out of property taxes. Nonetheless, other policies do highlight good investment opportunities. Urbanisation, Hukou and land reforms will likely benefit train manufacturers and social housing players. Financial reforms by way of interest rate liberalisation, opening up of the domestic stock markets as well as a resumption of IPOs will benefit brokers and insurers. China's focus on pollution control by promoting clean energy (gas, wind and solar) will benefit gas distribution and services as well as the renewable energy sector

Against a backdrop of slower growth, we will focus on structural opportunities and companies that have solid balance sheets and generate strong cash flows. Rising incomes continue to drive opportunities in the consumer space. We also see good opportunities in environmental protection and clean energy such as the gas distribution and services companies. We continue to favour the consumer sector, which will benefit from structurally rising wages and policy tailwind, and the healthcare sector, which will benefit in the longer term from an aging population and improved social welfare through healthcare support. In the financials sector, we are overweight the insurance sector and securities brokers, but underweight the banks due to on-going structural headwinds from net interest margin pressure and potential non-performing loans. We are also underweight on expensive defensives such as consumer staples and telecoms given headwinds of slower growth and higher capital expenditure.

Valuations in China are still very cheap, close to one standard deviation below its 12-year mean on price-earnings ratio, and in the case of price-book ratio - close to levels during the global financial crisis. Despite the stabilisation in the economy and potential for positive reforms, the current economic recovery is tepid and structural headwinds still persist. There will be a broad dispersion of company performance amidst this challenging backdrop and we believe in the principle of "survival of the fittest" when it comes to picking stocks.

In the long term, China continues to be supported by high savings and wage gains, which provide an attractive backdrop for consumption growth. Rising purchasing power of the middle and lower income population is a very supportive backdrop for investors. When China gets through the current necessary painful transition and rebalances its economy towards a more sustainable growth path, these positive fundamentals should reassert themselves and reward long-term investors.

ASEAN

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Underweight	7.0	9.1	↑	Major Cineplex Group
Consumer Staples	Overweight	9.5	9.0	↓	Thai Beverage
Energy	Underweight	3.5	5.7	=	PTBA
Financials	Underweight	31.5	32.9	↓	Kasikorn Bank
Real Estate	Overweight	12.0	7.6	↑	Asian Property
Healthcare	Overweight	1.5	1.1	=	Bangkok Dusit
Industrials	Overweight	17.5	14.8	=	Keppel Corp
Materials	Underweight	3.0	4.7	↑	Semen Gresik
Telecommunication	Underweight	10.0	11.1	↓	Axiata
Utilities	Overweight	4.5	3.9	↑	Perusahaan Gas

Benchmark: MSCI South East Asia

We continue to maintain our favourable view on the ASEAN markets in 2Q13 given the region's robust domestic demand outlook.

Thailand remains our top pick as we are confident of the country's economic recovery. In addition, the government is expected to increase public spending on infrastructure works, which will provide another boost to the economy. We favour sectors such as banking, property, healthcare and industrials which will benefit from improved domestic demand.

Indonesia remains an overweight, on the back of expected earnings upgrades and investment inflows. We increase our weight in the Philippines to a neutral position. The country's strong economic growth and healthy domestic demand are providing a tailwind. However we are prevented from taking a more bullish stance due to the market's rich valuations.

We are underweight Malaysia and Singapore.

At the sectoral level, we are overweight the consumer staples, real estate, industrials and healthcare sectors. We are underweight the financials, materials and energy sectors.

SINGAPORE

Sector Positioning					
SECTOR	2Q13 Policy	UOBAM Weight (%)	Benchmark Weight (%)	Change from 1Q13	TOP PICKS
Consumer Discretionary	Neutral	8.6	8.6	↑	Jardine Cycle & Carriage
Consumer Staples	Underweight	5.1	5.5	↓	Thai Beverage
Financials	Underweight	32.0	33.1	↓	DBS
Real Estate	Overweight	18.8	16.9	↑	Capitaland
Industrials	Neutral	24.5	24.3	=	Keppel Corp
Telecommunication	Underweight	11.0	11.7	=	Singapore Telecom

Benchmark: MSCI Singapore (changed from FSSTI wef 1 Jan 2013)

We have a constructive outlook for 2Q 2013, on the back of expectations that the equities market is likely to outperform other asset classes such as bonds. For the index to sustain its upwards move, corporate earnings upgrades will have to come through. We continue to hold the view that the worst in earnings downgrades is over, but upgrades might take some time to filter through.

We believe companies with significant earnings generated overseas are better placed to navigate current domestic challenges of higher inflation and lower growth. Our investment picks are centered on companies thriving on external growth, particularly growth from China and the ASEAN markets.

GLOBAL
FIXED INCOME
STRATEGY

Fixed Income Overview

Fixed income				
Asset Allocation	2Q13 Policy	UOBAM weight (%)	Benchmark weight (%)	Change from 1Q 2013
Developed	Underweight	30.0	70.0	=
Government	Underweight	40.0	71.0	=
High Grade	Overweight	52.0	21.0	↓
High Yield	Neutral	8.0	8.0	↑
Emerging	Overweight	70.0	30.0	=
Asia	Overweight	32.0	30.0	=
Latin America	Neutral	33.0	33.0	=
CIS/EE**	Underweight	24.0	27.0	=
Middle East/Africa	Overweight	11.0	10.0	=

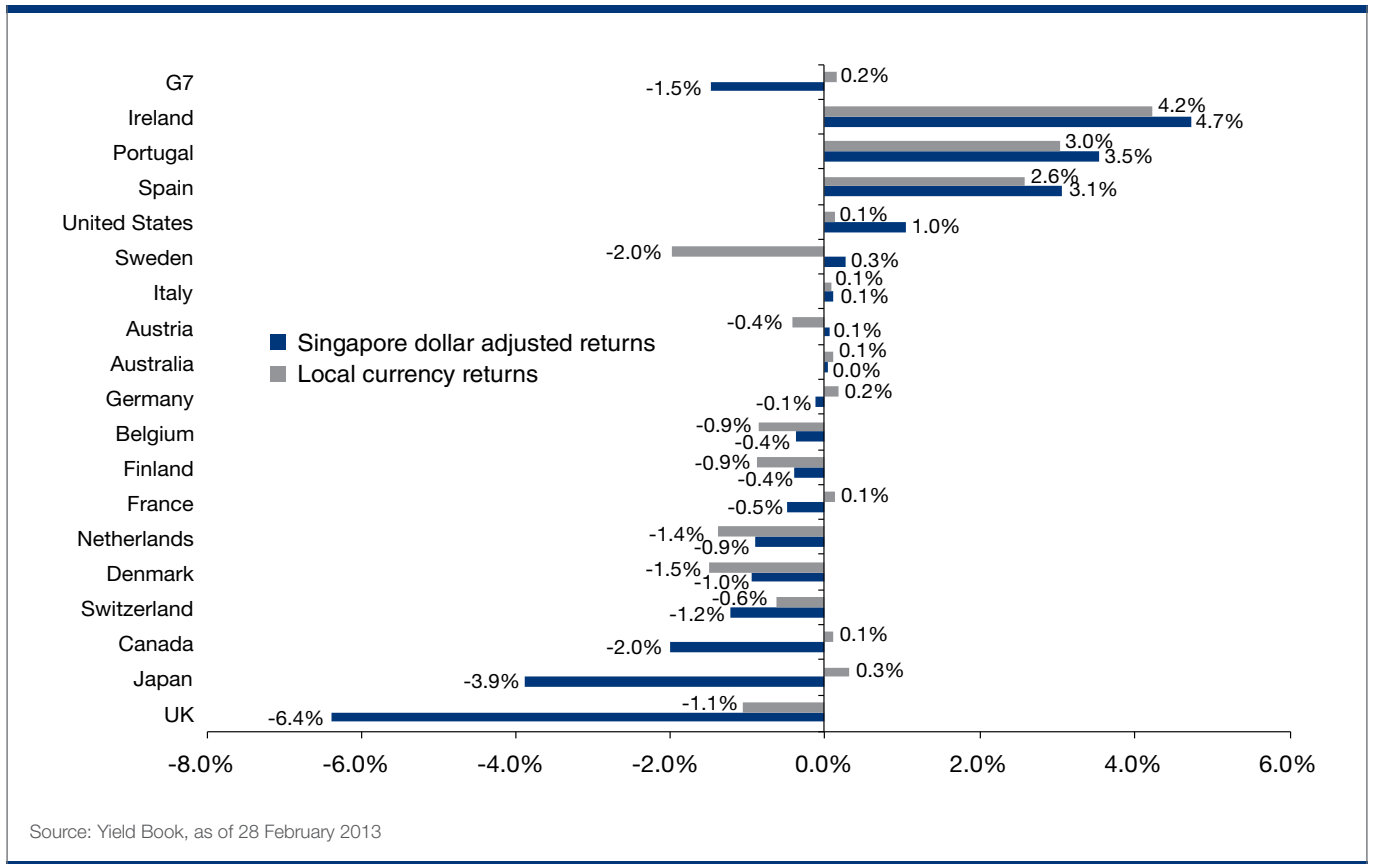
** CIS – Commonwealth of Independent States, EE – Eastern Europe

In the developed markets, we remain underweight on Government debts specifically in the Eurozone area. We reduce our overweight on investment grade corporate credits due to possibly higher rates on the long end of the US yield curve. We are neutral on high yield credits on the back of sustainable economic recovery in the US. Duration will be kept neutral/ short to the benchmark.

In emerging markets, we maintain an overall overweight relative to the developed markets. We are overweight on Asia and CIS, neutral on Latin America, Middle East and Africa, and underweight on Eastern Europe. We are selectively positive on local currency EM credits, supported by attractive carry and superior growth prospects.

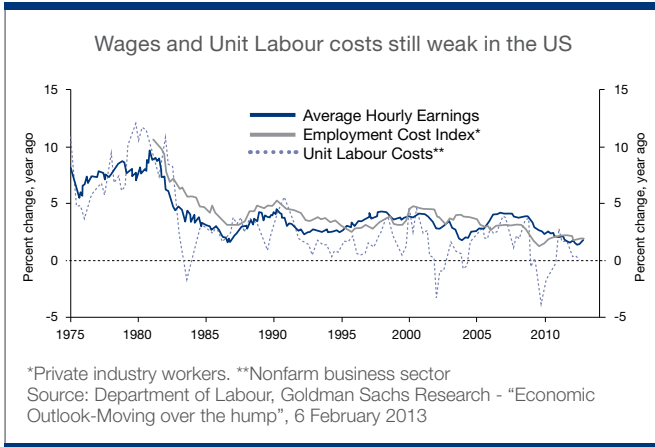
GLOBAL FIXED INCOME

Bond Market Returns



The G7 index has returned -1.5 per cent year-to-date in Singapore dollar (SGD) terms given the underperformance in the UK, Japan and Canada. The peripheral European countries were the best performers because the market crisis in the Eurozone has mostly been sidelined following the Outright Monetary Transactions announcement last year. US Treasury also performed well year-to-date returning one per cent in SGD terms as the US dollar (USD) strengthened against the SGD. UK Gilts were the worst performer in the G7 in SGD terms as the British pound (GBP) fell significantly against all major currencies due to quantitative easing (QE) expectations and persisting economic concerns in the UK. Japan's negative return in SGD terms was also due to continued weakness in the Yen.

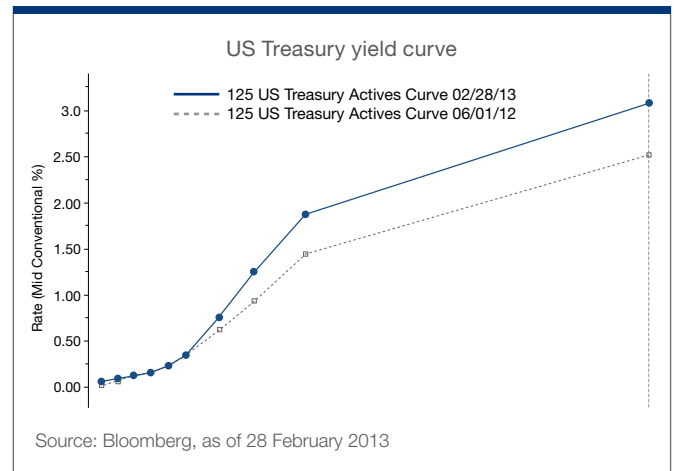
The US continued to exhibit slow but steady growth in the recent quarter. Although the GDP growth has been sub par, the employment scenario and the housing market has seen a robust recovery during this quarter. The US consumer has remained supportive of the growth outlook even though the year started with an increase in tax rates after expiration of the Bush-era tax cuts. We expect that this will be a year of transition, with economic growth improving in the second half of the year. The private sector should continue to show resilience, supported by the housing market, consumer spending and the willingness of the US banks to lend. Inflation is unlikely to gain as there is still underutilisation in the economy and wage growth is well below its historic average. Capital spending is also likely to improve given the current high margin levels in the corporate sector accompanied by lagging growth rates.

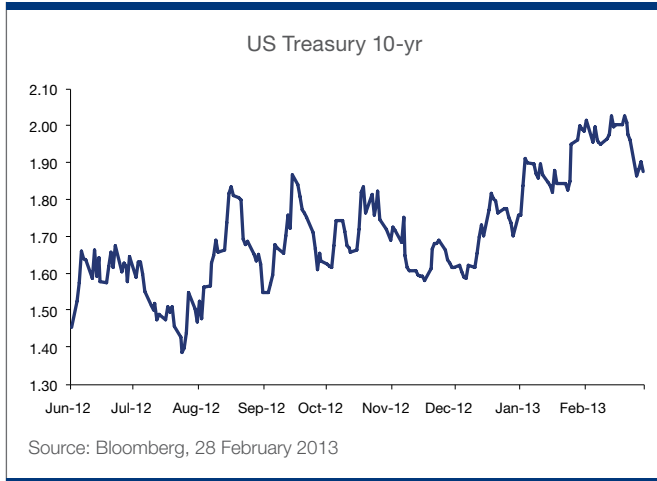


The Federal Reserve (Fed) maintained its dovish stand and continued its QE by buying US\$85 billion of Treasury bills and mortgage backed securities (MBS) every month. A debate has started among the Federal Open Market Committee (FOMC) members regarding the costs and benefits of QE on the economy in the long term. FOMC's chairman Ben Bernanke reiterated the Fed's stand in his recent comments. As this round of QE is not time-bound, we expect discussions around its risks and exit strategy to continue in subsequent FOMC meetings. This may create some volatility in the rates market, which is fearful of an early Fed exit. We expect QE to continue at its current pace this year, before starting to taper off next year. We will be watchful of any signs given by the FOMC regarding their concerns of a potential threat to financial stability due to overheating in the credit market.

The much debated sequester of US\$85 billion cuts triggered on 1 March includes even cuts in the defence sector and discretionary spending. The expected impact on GDP is -0.7 per cent. We expect the sequester to have limited market impact as the issue is more political rather than economic. There is some chance that we may see a partial reversal of the sequester cuts if pressure builds up from various impacted sectors, especially defence, which has already taken the biggest hit from the fiscal tightening.

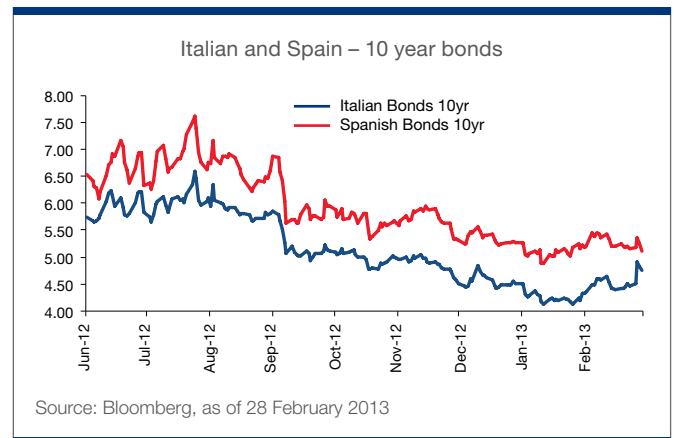
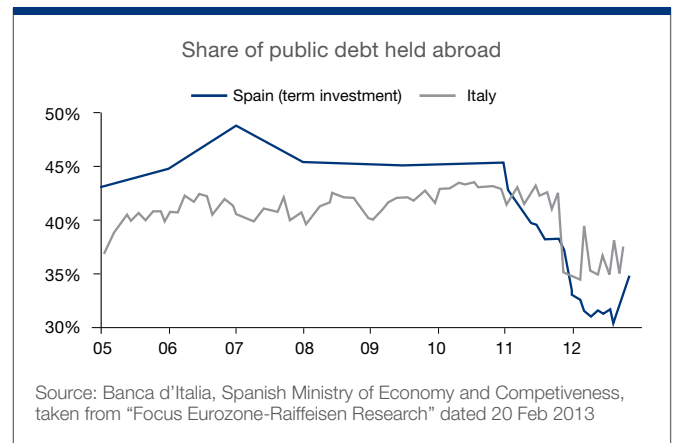
In the US treasury market, we expect the yield curve to steepen but remain range bound between 1.9 per cent to 2.3 per cent in Q2 on the back of improving economic growth. We foresee private sector demand, healing of household sector (creating wealth effect) and stabilisation in the global economies to remain the drivers of growth this year. However, the volatility in the Eurozone due to the hung parliament in Italy is likely to keep the yields moderated. We are neutral on US allocation, underweight on duration, and overweight on the USD.





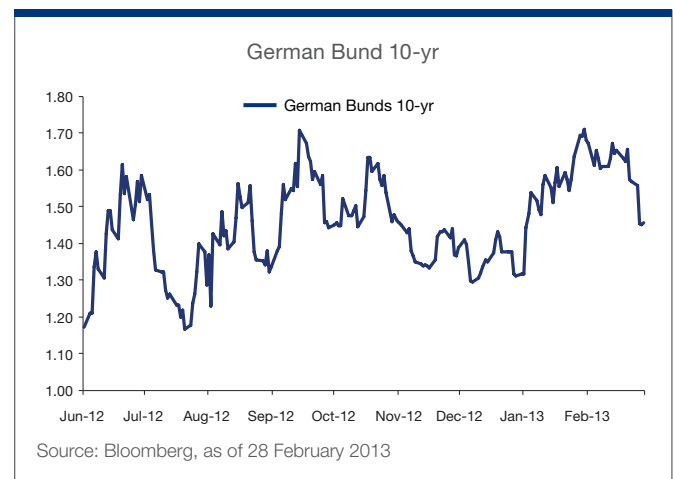
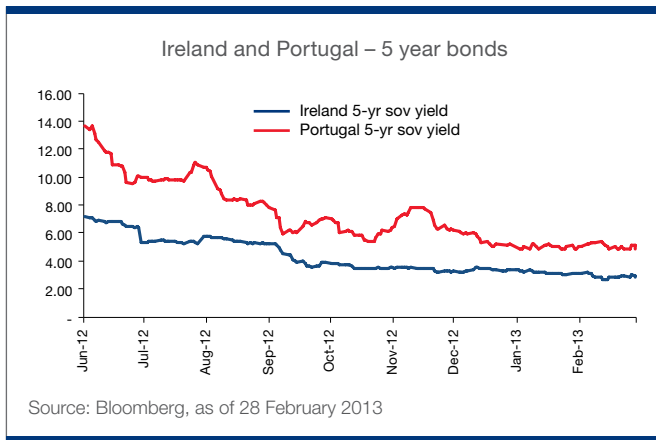
Structural issues in the Eurozone remain. We expect the contraction to continue in 2013 but the divergence between the core and peripheral Eurozone nations will widen. As private and banking sector deleveraging and public sector consolidation have a long way to go in most of the Eurozone countries, the low growth environment will continue. However, the OMT announcement made last year by the European Central Bank (ECB) did provide a backstop for the peripherals, solving considerably the liquidity crisis. As the announcement of the OMT itself has been quite effective, we do not expect it to be triggered unless there is some unexpected event. The key concerns in the Eurozone are the distractions from structural reforms by the peripheral countries - the relief in the sovereign bond market, rising social unrest regarding acceptance of reforms and bailout in Cyprus.

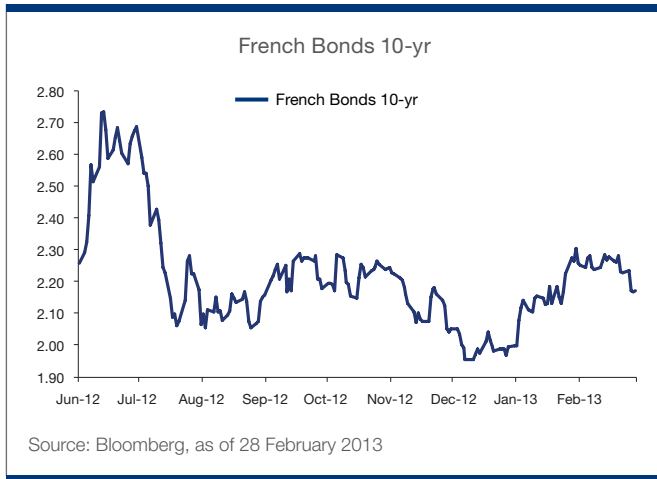
The Italian general election resulted in a 'hung parliament', with their lower House going to the left coalition and the Upper House split three ways. We think that the political uncertainty in Italy will continue for a few months and will conclude with a re-election. As a result, structural reforms in Italy to address its competitiveness and productivity problems are likely to be delayed. Therefore, we are underweight on Italy. Spain's fiscal adjustment, on the other hand, is moving in the right direction. Its 2012 budget deficit was reduced to 6.7 per cent, a significant improvement from 2011's nine per cent. Since the OMT announcement last year, Spain's sovereign bonds have also seen renewed interest from international investors, whose share has fallen significantly when the Spanish government bond yields soared at the end of 2011.



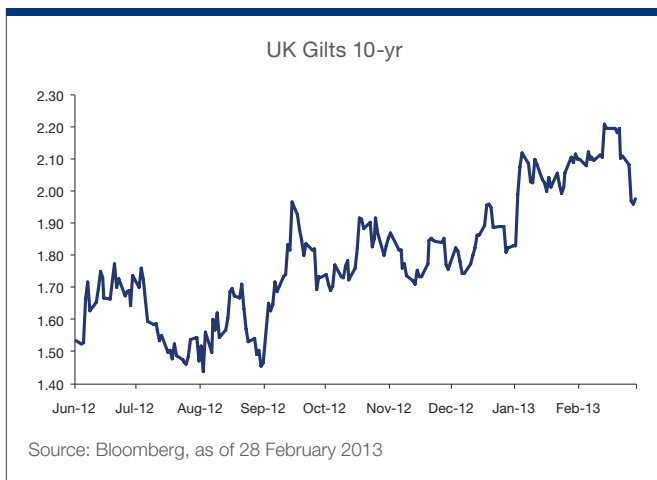
At the point of writing this report, the Euro bloc has announced that it is targeting a Cypriot bailout deal by the end of March, which we think may not be achieved as the negotiations around the terms of the bailout will take some time. However, the tone of discussion has been positive. We do not expect Cyprus to end up in a “Greece-like” scenario and expect the bailout deal of euro 17 billion to be achieved by May. Policymakers also remain supportive of the other countries in the programme, such as Ireland and Portugal, given that they are making good efforts on meeting their fiscal and structural reform targets. This was evidenced in the recent Euro group meeting, at which ministers agreed to consider extending the official loan maturities of Ireland and Portugal. International investors also remain positive on these countries as both countries have successfully syndicated deals this year. Ireland is also expected to tap the market with a few more syndicate deals to test its accessibility to the market before fully returning to the markets.

In core Europe, Germany, after hitting a soft patch at the end of 2012, has seen its recent economic data starting to turn around, albeit at a slow pace. With Germany reorienting its exports from the Eurozone to the rest of the world, leading indicators are pointing to a positive recovery from the lows seen in the last quarter of 2012. With the upcoming federal election in September, we expect market stabilisation to take top priority, prompting risk-averse policymaking. We may start to see signs of wage inflation given the divergence in the economic situation in Germany versus the peripheral Eurozone nations. In France, strong investor demand for better yields than bund yields is helping to keep the current French yields at low levels. As fundamental problems of high debt, budget deficit and unemployment continue to persist, structural reforms with a focus on fiscal consolidation and labour market are needed for France to regain competitiveness. We expect the economic stagnation to continue after a shallow recession in the first half of this year. Given the current yield levels, we are underweight on both Germany and France with a short duration in both. However, as the policymakers have been successful in keeping the market crisis at bay while averting a Eurozone breakup scenario, we are neutral on the euro.





UK's macroeconomic situation continued to be below expectations, with persistently above-target inflation despite stagnant real GDP. With negative GDP growth in the last quarter of 2012, the country achieved zero growth for the year as a whole. We expect the Bank of England (BoE) to restart the QE programme soon, given fears of a triple dip recession. Mark Carney, the next governor of BoE, has signalled his focus will be on pro-growth policies, keeping rates low with a flexible inflation target. We expect the yield to remain range bound in the 1.90 - 2.10 per cent levels and are overweight on Gilts with a long duration. We are neutral on the GBP as most of the QE expectations have been priced in.



The Reserve Bank of Australia (RBA) has cut the policy rate by 175 basis points since late 2011 in response to the weakening outlook for domestic economic activity and benign inflation. In the most recent monetary policy meeting in early March this year, the RBA left the cash rate unchanged at three per cent. Its assessment of the economies in the US, Europe, China and Asia is generally that of stabilisation though the forecast for global growth is a little below average. The monetary policy statement mentioned that resource investment is approaching a peak while there is scope for other areas of demand to strengthen. The central bank assessed that inflation will be consistent with the target (two to three per cent) over the next one to two years, as companies focus on improving efficiency under conditions of moderate demand growth and a somewhat softening labour market contains wage pressure. The RBA left open the possibility of easing policy rate further, while noting that the substantial easing and easier monetary conditions are having some of the expected impact although the full impact will still take some time to become apparent. The central bank also assessed that the exchange rate has remained higher than expected given the decline in export prices.

Investment outside of mining is subdued but stabilising while mining investment is approaching a peak. The terms of trade for Australia is at a multi-year high and this in turn could coincide with some weakening in its currency. Australia's economy expanded by 0.6 per cent quarter-on-quarter in last quarter of 2012, with growth supported by net exports, a modest upturn in household consumption and public demand.

While a bias towards easier monetary policy tends to suggest a weaker currency ahead, the high sovereign rating and high government bond yields compared with that of many other developed economies have been a strong support for the currency. We think that the RBA has room to ease interest rates further but we expect that the magnitude of cuts by year end will be less aggressive than the 50 basis points priced by the market. We share the view of the central bank that the currency is stronger than expected. We will underweight the currency and hold a neutral weighting on the Australian government bonds.

Japan's new Prime Minister Shinzo Abe managed to talk down the Japanese Yen and had the stock market cheering while government bond yields were kept low. A set of policies meant to pull Japan out of deflation and weak growth had been advocated and comprises mainly of bold monetary policy, fiscal policy and growth initiatives. The Japanese Yen sold off on expectations that the currency could weaken from more aggressive monetary policies such as extending the maturity of bond purchases, increasing the size of asset purchases, purchasing foreign bonds and revision of the Bank of Japan Act to hold the central bank accountable for achieving the inflation target. Beyond using fiscal and monetary policy to lift the economy from deflation, economic growth also needs to be sustainable. Some of the potential growth initiatives include lowering the corporate tax rate which is currently extremely high, gift tax reforms and deregulating some sectors. With Japan's debt to GDP level standing at beyond 200 per cent, the success of the growth initiatives is important to ensure debt sustainability while fiscal expansion is implemented.

Besides demographic changes, finding a reliable energy source is another big challenge the Japanese economy faces. The currency weakness was partly brought on by the shrinking current account surplus which resulted from an increase in energy imports after the shutdown of nuclear plants two years ago. While a weaker Yen may potentially boost competitiveness of Japanese exports, it will also inflate the import cost of energy.

It will probably take some time before the benefits of a cheaper Yen on exports will outweigh the higher cost of imports. The recovery of exports will also depend on external demand and at least in the near term, global growth is expected to be low. If the US treasury yields increase faster than expected and the interest rate differential widens, the Yen could weaken further. However, if the policies expected by the market do not come to fruition, the Yen trajectory could potentially reverse. While the Yen has weakened more than 20 per cent against the USD since last September and has the potential to reach triple digits against the USD, it is probably close to the resistance level based on market positioning and pending further impetus. We would recommend to underweight the Japanese government bonds and hold a neutral weighting on the Yen.

EMERGING MARKET FIXED INCOME

In the last three months, emerging market (EM) sovereign bonds gave up some of their prior gains, due primarily to the upward movement in US Treasury yields, which pushed EM bond yields higher. The 10-year US Treasury yield started the year at 1.76 per cent and was trading at 1.88 per cent by the end of February, reaching a high of 2.06 per cent during the period. The upward movement in US Treasury rates reflects the better economic data coming out of the US, leading the market to position itself for a possible end to QE by the Fed.

Good news out of the US includes a pick up in the ISM indicator from 50.2 in December 2012 to 53.1 in January and 54.2 in February. Employment data has also been good with the US unemployment rate falling to 7.7 per cent in February from 7.8 per cent in December 2012. Overall, there is a sense that the US recovery is underway and that the Fed's loose monetary policy will come to an end sometime in the future. Our own view concurs with the recent data. We think that the 10-year US Treasury yield will trade between 1.8 per cent and 2.2 per cent. However, we do not think the Fed will tighten monetary policy this year as inflation remains well contained.

EM growth also showed some signs of improvement with trade data picking up. For example, Brazilian exports rose 2.1 per cent year-on-year (y-o-y) in Q4 2012 after falling by 3.2 per cent y-o-y in Q3 2012. In Singapore, total trade rose 1.4 per cent y-o-y in January after falling by 8.2 per cent y-o-y in the prior month. Meanwhile, consumer prices have remained subdued, with food and energy prices falling.

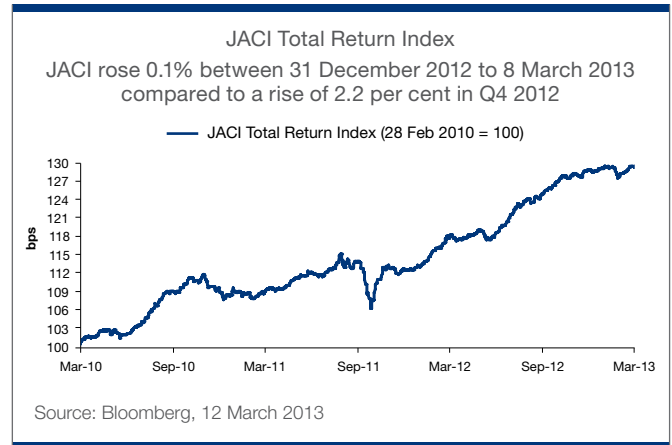
This backdrop of improving growth and subdued inflation should be positive for credit spreads. We have seen EM sovereign bond spreads widen from the tight levels of last year, while spreads on EM corporate bonds have seen some tightening. EM High Yield bonds continue to outperform EM Investment Grade bonds.

Going forward, with our positive outlook for credit spreads, we prefer to hold EM corporate bonds over sovereign bonds. This strategy has worked for us and we believe there is still potential for further outperformance. In terms of interest rate risk, we are more cautious given our view that 10-year US Treasury yield will trade between 1.8 per cent and 2.2 per cent. We prefer to be short on credit duration against the benchmark. Credit selection will be important in the coming quarter and likely so for the foreseeable future. In terms of currencies, we remain long Mexican Peso and Chinese Yuan as our preferred EM currency exposure.

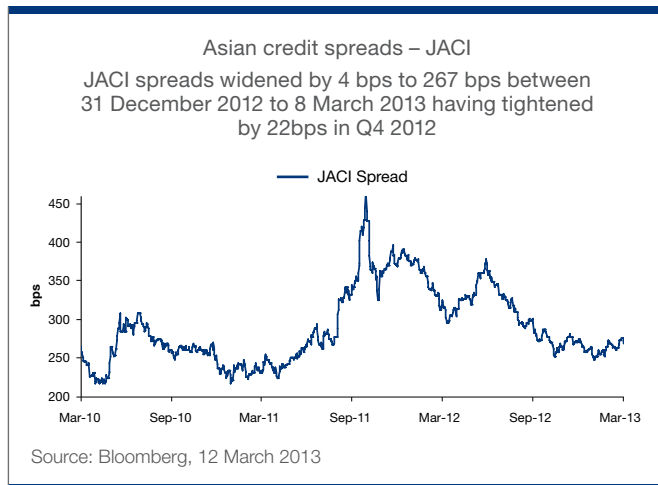
ASIA FIXED INCOME

The Asian credit market performance was weak in Q1 2013. The Asian credit market returned a dismal 0.1 per cent during the period between 31 December 2012 and 8 March 2013 on the back of credit spreads widening and 10-year US Treasury (UST) yields rising by 28.5 basis points (bps) since the beginning of the year. Asian credit spreads widened by 4bps to 267 bps during this period. The performance in Q1 2013 pales in comparison to the 2.2 per cent total return in Q4 2012 and 4.8 per cent total return in Q3 2012.

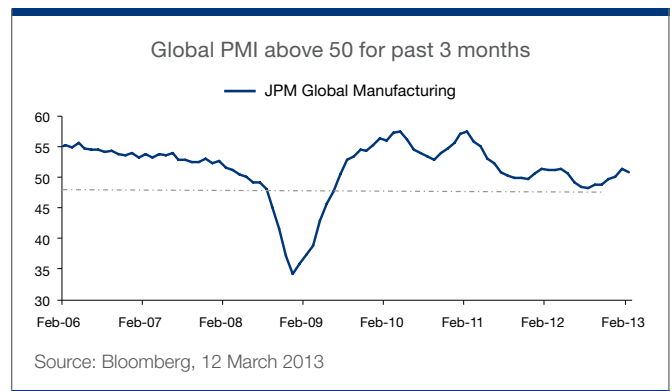
The key reason for the poor Asian credit performance was the rapidly rising UST yields. The secondary reason was the heavy supply of new bond issuances in the first two months of 2013. There was a gross bond issuance of USD 26.8bn in the first 2 months of 2013 versus USD 23.4 bn over the same period in 2012 - a rise of 15 per cent.

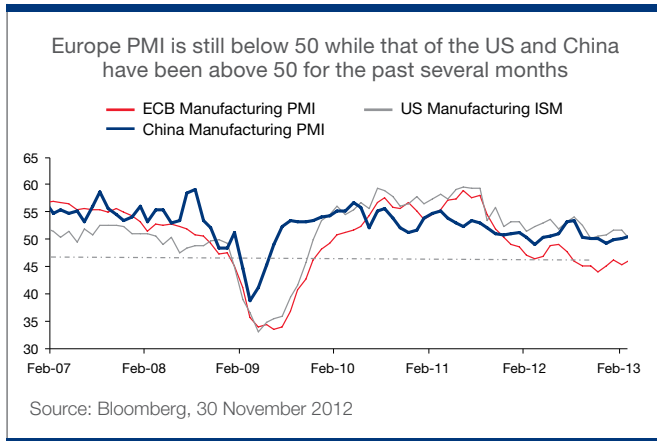


Looking ahead, we see signs of the US economy strengthening with the recent Purchasing Managers' Index (PMI) and non-farm payroll data surprising on the upside. This should continue to put upward pressure on UST yields.

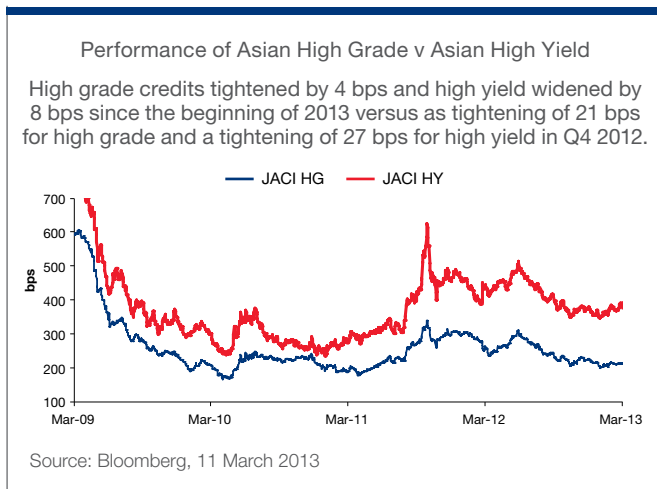


The global economy continues to show signs of a recovery. For the third consecutive month, the global PMI posted a reading stronger than 50. The global PMI posted a reading of 50.8 in February (51.4 in January). China (50.1), the US (54.2) and Germany (50.3) all posted readings above 50 in February although the Eurozone PMI remained depressed at 47.9 in February.





At a spread of 267 bps on 8 February, the Asia credit market is pricing in real GDP growth of around 7.5 to 8 per cent over the next 12 months. Our fair value for Asia credit spreads remains at 380 bps as we expect real GDP growth of average 6 to 6.5 per cent over the next 12 months. We think that valuations for Asian credit, both on spread and yield basis, are looking stretched. As a comparison, the Asia credit market gave an average yield of around 6 per cent from 2005 to 2007. Despite the stretched valuations, we do acknowledge that massive liquidity injections from central banks globally could help to support the Asian credit market.



We have moved our portfolio to a slight overweight on high yield credits and a slight underweight on high grade credits. Previously we were underweight on high yield credits and overweight on high grade credits. Within the high grade credits sector, we are overweight short duration offshore Renminbi (CNH) bonds.

The market is currently supported by massive liquidity injections by the central banks of developed nations. However, as US interest rate rises, the Asian credit market, especially the high grade credits, could come under pressure. Our current portfolio positioning is geared towards protection against capital losses from rising interest rates. Our overweight position on high yield credits will offer some protection against rising interest rates as high yield credits are less sensitive to interest rate rises. Meanwhile, short duration CNH credits are relatively immune to rising interest rates as most of them have a maturity of less than three years.

In **High Grade**, we are overweighting China, Hong Kong, Singapore and Australia high grade corporates. These credits include Leighton, Cosco Pacific, Temasek Holdings, Champion Reit, **Sun Hung Kai Properties, Wesfarmers, AIA, PCCW** and **Capitaland**. These companies offer decent yield over similarly rated credits and duration without a compromise in credit quality.

In **High Yield**, we continue to prefer good quality corporate bonds like **MIE Holdings, LongFor Properties, Guangzhou R&F, Long Yuan, Kaisa, Bharti Telecoms** and **Fosun**. These corporates have strong balance sheets and solid business models. Within the sovereign high yield space, we like the **Mongolian** sovereign bonds.

SINGAPORE FIXED INCOME

Second Quarter 2013 Macro Review

Q4 2012 real GDP grew 1.5 per cent y-o-y from 0 per cent in Q3 2012. Full year 2012 real GDP growth slowed to 1.3 per cent from 5.2 per cent in 2011. The manufacturing sector continued to be the key drag on growth in Q4 2012. This sector shrank 1.1 per cent y-o-y (revised up from -1.5 per cent y-o-y) while the services sector continued to expand, rising 1.7 per cent y-o-y in Q4 from 0 per cent in Q3. Meanwhile, the construction sector slowed to 5.8 per cent y-o-y in Q4 2012 from 6.7 per cent y-o-y in Q3 2012. The government expects real GDP to grow 1 to 3 per cent in 2013. We expect real GDP growth of 2.5 per cent in 2013.

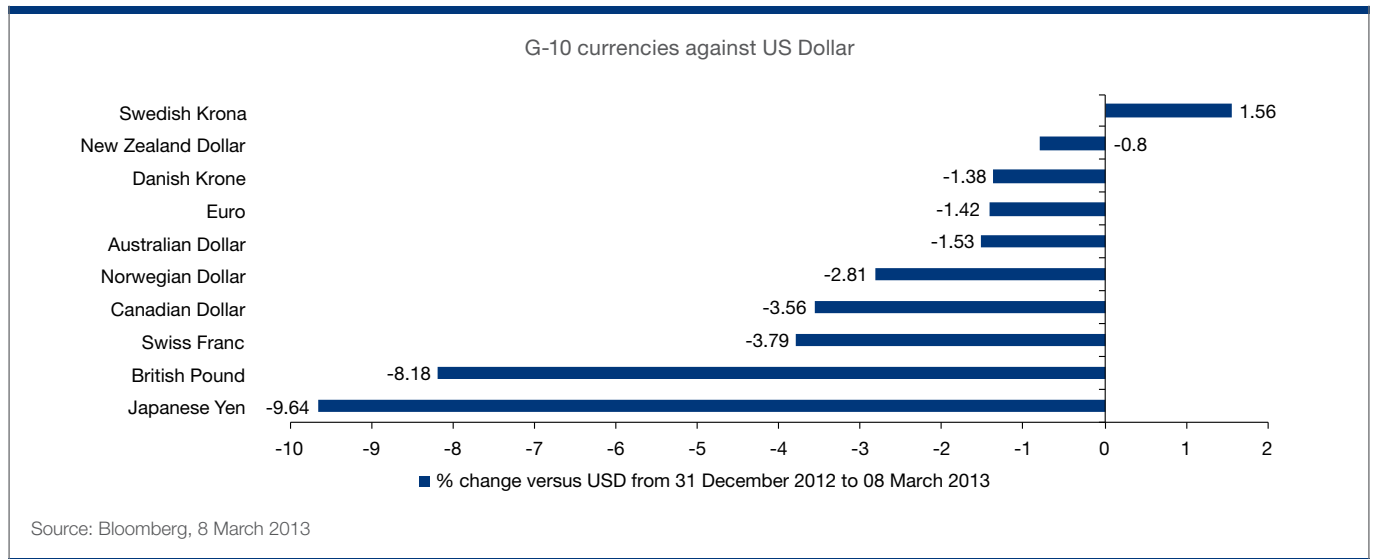
CPI inflation slowed to 4.0 per cent in Q4 2012 from 4.2 per cent in Q3 2012, which took 2012 inflation to 4.6 per cent from 5.25 per cent in 2011. Core inflation slowed to 2.0 per cent y-o-y in Q4 from 2.3 per cent y-o-y in Q3 2012. Full year core inflation came in at 2.6 per cent from 2.2 per cent in 2011. Despite the slower inflationary pressures in Q4 2012 and sub-par growth over the last few quarters, we think that the government remains highly concerned over the high inflation data and hence expect the Monetary Authority of Singapore (MAS) to keep the monetary policy tight in the next monetary policy meeting in April 2013. While the MAS is likely to maintain its tight monetary policy in 2013, we believe that weakness in other Asian foreign currencies like the Korean Won (KRW), Taiwan dollar (TWD) and Japanese Yen (JPY) could drag the SGD weaker against the USD over the next three months. We expect the SGD to trade in the 1.2450 to 1.2550 range against the USD over the next three to six months compared to 1.2385 at end February.

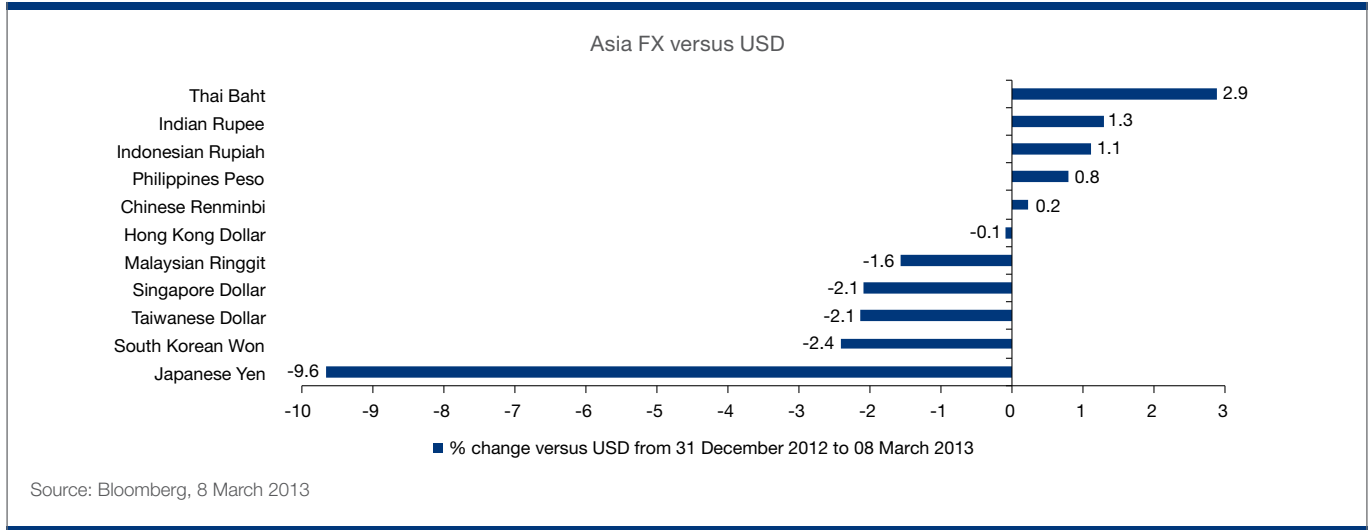
CURRENCIES

CURRENCIES

Fourth Quarter 2012 Review

Most G10 foreign currencies (FX) weakened against the US dollar (USD) during the 31 December 2012 to 08 March 2013 period as better economic US data and rising US interest rates spurred a rally in the USD. The inconclusive Italian elections, poor UK macroeconomic data as well as dovish statements from the Japanese government also supported the USD against developed countries' FX.

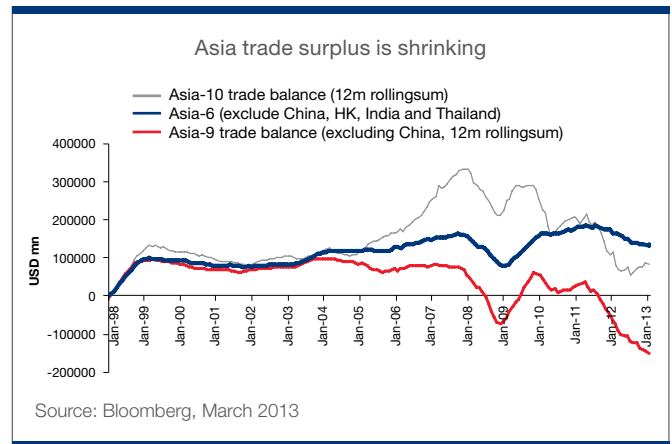




Outlook & Strategy

The Asian Dollar Index (ADXY) fell 0.6 per cent during the 31 December 2012 to 8 March 2013 period. The price actions in the FX market since the beginning of the year suggest that the outlook for Asian FX is increasingly negative.

First, the US economy is now recovering steadily. Second, the USD is around 25 to 30% undervalued against developed nations' FX. Third, the Japanese government has indicated that it will embark on aggressive monetary easing, which is likely negative for JPY as well as close competitor currencies like KRW, TWD and SGD. Last but not least, the trade surplus for Asia excluding China is now shrinking steadily. A falling trade surplus will be negative for Asian FX in the long term. We expect the USD to appreciate further against most G10 FX and the SGD in Q2 2013.



CURRENCY FORECAST

Currency	Against USD 8 March 2013	Forecast End 2Q 2013
Japanese Yen (JPY)	96.0	97.5
Euro (EUR)	1.3005	1.2900
Singapore dollar (SGD)	1.2477	1.2550

COMMODITIES

Neutral in Commodities

Commodities				
Asset Allocation	2Q13 Policy	UOBAM weight (%)	Benchmark weight (%)	Change from 1Q13
Gold	Neutral	25.0	25.0	↓
Base Metals	Neutral	20.0	20.0	=
Agriculture	Neutral	20.0	20.0	↑
Energy	Neutral	35.0	35.0	=

We retain our neutral call on commodities. On balance, global economic data has shown some improvements even though they lack steady upward momentum. The US currently enjoys the strongest data releases, helped by an improving housing market and increased domestic energy production. The Chinese economy appears to have softened into the Chinese New Year period but its macroeconomic data are expected to improve in the coming quarter. While Europe remains the most subdued region, there have been positive surprises from Germany as German businesses are increasingly upbeat about their future prospects. More importantly, the European Central Bank and the prospective financial fire-power of the European Stability Mechanism have capped interest rates in the European sovereign debt markets and reduced concerns of an economic crisis.

While the economic outlook is more positive, the overall set of monthly data still appears rather mixed and there are lingering concerns that future global growth rates may appear sub-par compared with that seen in the last decade. To date, commodity prices in 2013 have generally seen low single-digit per cent gains. The lack of strong demand in the global economy means that the commodity sector may remain dependent on monetary and fiscal policies to stimulate economic activity. However, liquidity measures alone may not be sufficient to maintain commodity prices at higher price levels.

We have lowered our call on **Gold** to neutral, given that the March to August period is typically a quiet part of the year due to a lack of festive buying. However, we remain positive on gold's prospects given the US Federal Reserve's accommodative monetary policy and the prospects of renewed monetary easing by the Bank of Japan and Bank of England. There have been concerns about possible divestment from gold, fuelled by the fall in aggregate gold ETF holdings from 2,760 tonnes in December 2012 to 2,640 tonnes as at end February 2012. Yet fluctuations in gold ETF holdings are not unusual. More importantly, latest data from the World Gold Council shows that central banks remain aggregate net buyers.

Within the **Energy** space, we hold a neutral position for both Crude Oil and Natural Gas. Crude oil prices remain evenly balanced, with difficulties in boosting non-OPEC supply offsetting relatively lacklustre global demand. Supply concerns also come from potential disruptions in the Middle East and Africa. As previously noted, a number of OPEC producers now incorporate crude oil prices close to the US\$100 per barrel level when forecasting domestic budget expenditure and this suggests that OPEC production would be cut if crude oil prices fell sharply below this level. A reduction in domestic rigs has seen US natural gas stabilise at the US\$3.50 per million cubic feet (mcf) level and we believe prices will remain at this level even when the market moves out of the winter months.

We move to an overweight position in **Bulk Commodities** and a neutral position in **Base Metals**. Iron ore prices have maintained their strength following the strong rebound in prices in the fourth quarter of 2012. China remains the key market for seaborne iron ore prices and current steel data is supportive of the normal seasonal strength into mid-year. This should also benefit coking coal prices. Thermal coal prices appear to have bottomed at the US\$90/tonne level and should be helped by a decline in hydropower production in China. A re-rating of base metals is expected given higher US industrial production and rising infrastructure spending in China.

We move to a neutral weight on **Agriculture**. Grain prices have continued to fall from the elevated levels reached after the droughts in the United States in 2012. Investors are now tracking the monthly harvest forecasts provided by the US Department of Agriculture to see if the adverse weather conditions will again threaten current expectations of significantly higher US crop production in 2013. We expect to increase exposure to agriculture-related assets in the event of adverse weather conditions.

Contact Details

SINGAPORE

UOB Asset Management Ltd

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

MALAYSIA

UOB-OSK Asset Management Sdn Bhd

Address 3rd Floor, Plaza OSK, Jalan Ampang, 50450 Kuala Lumpur
Tel (03) 2732 1181
Fax (03) 2732 4311

THAILAND

UOB Asset Management (Thai) Company Limited

Address 11th Floor, 191 South Sathon Road, Yannawa, Sathon,
Bangkok 10120 Thailand
Tel (662) 676-7100
Fax (662) 676-7880-7

BRUNEI

UOB Asset Management (B) Sdn Bhd

Address FF03 to FF05, The Centrepoint Hotel, Gadong,
Bandar Seri Begawan BE 3519, Brunei Darussalam
Tel (673) 2424806
Fax (673) 2424805

TAIWAN

UOB Investment Advisor (Taiwan) Ltd

Address Union Enterprise Plaza, 16th Floor, 109 Minsheng East Road, Section 3,
Taipei 10544
Tel (886)(2) 2719 7005
Fax (886)(2) 2545 6591

JAPAN

UOB Asset Management (Japan) Ltd

Address 13F Sanno Park Tower, 2-11-1 Nagatacho, Chiyoda-ku,
Tokyo 100-6113 Japan
Tel (813) 3500-5981
Fax (813) 3500-5985

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