



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	3.4	4.0	28.6	28.6
MSCI World	3.1	3.5	24.2	24.2
MSCI USA	3.3	5.3	21.5	21.5
MSCI Europe	2.9	2.6	28.4	28.4
MSCI Japan	3.1	-1.9	3.3	3.3
MSCI AC Asia ex-Japan	5.8	6.2	64.6	64.6
MSCI Emerging Markets	5.3	8.0	70.7	70.7

Returns in Singapore dollars. Source: Bloomberg, 31 December 2009

World equity markets advanced further in December, with the MSCI AC World Index up 2% in US dollar terms. Equity markets registered strong gains driven by a significant re-rating from the distressed levels at the start of the year. The MSCI AC World Index rose 31.5% over the 12 months ended December.

The continued rebound in markets was underpinned by a pick-up in broader economic indicators and firming earning expectations. Improving macroeconomic indicators, stabilising housing prices, recovering consumer confidence and leading indicators, and stabilising employment data all helped to buoy market sentiment. Emerging Markets and Asia (ex-Japan) continued to rally higher.

Asia and Emerging Markets performed strongly in December and have racked up impressive gains this year, up 68% and 75% respectively. Developed Markets, with the exception of Japan registered respectable gains as well. Among the Developed Markets, the US had been the laggard but gained ground in the final quarter, as the dollar recovered slightly.

The Japanese market remained lackluster, adversely impacted by weak export demand, domestic deflation and concern over profit margins and corporate profitability. The corporate sector, with its export orientation, is a leveraged play on the global recovery. The key challenge is the thin levels of profitability and poor return on capital generated by the corporate sector. The transition to a new government did not provide any encouragement either, with policy direction largely deemed to be negative for the market.

European markets are up 31.5% this year, in US dollar terms. While the European corporate sector is a potential beneficiary of a recovery in global growth, its financial sector remains a risk due to likely regulatory changes. A stronger Euro is also a significant headwind for the export oriented





industrial sector moving into 2010. A weaker recovery could challenge operating margins and may necessitate an acceleration of corporate restructuring. Valuations for the Eurozone remain cheap compared to other regions.

Emerging Markets remain the bright spot in terms of performance. This is broadly justified as Emerging economies do not face the same challenge to growth. They do not have the domestic debt overhang or fiscal challenges that are evident in the Developed world. With continued signs that we are in the early innings of a recovery, the outlook for Emerging Markets remains positive. However, one needs to be aware of some of the key challenges still ahead, namely the need to re-tool the economic models to achieve a better balance of growth. Until this happens, growth may remain below potential. Valuations are less supportive than they were previously and earnings will be the key driver of market performance moving forward.

## OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Underweight	-	The US economy has bottomed and there are strong signs of a broadening recovery from housing, construction, to industrial output. The corporate sector looks set to benefit from a recovery in demand with earnings and profitability is projected to rebound. However medium term growth is likely to be modest and we stay Underweight.
Europe	Underweight	-	Leading indicators in Europe rebounded sharply, setting the stage for a recovery in earnings. European valuations are amongst the cheapest in the world and markets should benefit from re-rating. However, structural concern both in terms of the credit outlook, the need for financial sector reform, and the need for companies to serve public policy agenda, suggest that some of the perceived upside may be missed. We also stay Underweight.
Asia (ex-Japan)	Overweight	-	Growth in Asia has rebounded sharply as have earning expectations. A combination of aggressive monetary easing along with fiscal stimulus has helped to underpin growth in much of the region. Moving forward, as stimulus is removed, external demand will be a key driver to growth. The region is no longer cheap but we see the potential for earnings upgrades and we maintain our Overweight position.
Japan	Underweight	-	Even after a decade of under-performance, Japan was not immune to the global slowdown. The Japanese market has a large concentration of export oriented and cyclical companies that should benefit from the recovery. The bad news is that corporate profitability has to recover a long way to warrant meaningful capital allocation. We stay Underweight.



Latin America	Overweight	-	Like the rest of the world, Latin America has suffered a decline in GDP, but is recovering quickly due to strong domestic demand. Latin America still continues to represent the best long term investment opportunity for equity investors, with its strong growth and the highest return on capital of any region. However, following strong price gains, the region is no longer cheap. We retain our Overweight position.
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3Q GDP data has confirmed that the global economy has exited recession. More recent labour market data provided strong evidence that the recovery is entrenched and that growth will continue to gather momentum into 2010. The need for de-leveraging in the Developed world and the need to rein in fiscal deficits pose a risk to growth if not managed carefully. We believe that policy makers will maintain an accommodative monetary stance through the better part of 2010 to mitigate the risk attendant on fiscal constraint.

In order to stave off depression, governments undertook unconventional actions and have rapidly accumulated debt. A clear but gradual exit strategy is essential in order to avoid a potential shock to confidence as governments step back from guaranteeing deposits and debt, divest from investment holdings, lift policy rates, balance budgets and implement structural changes to avoid any potential threats to confidence into the recovery.

The industrial world benefitted in 2009 from a rundown of low cost inventories and efforts to rein in operating costs. And while production and sales are slated to rebound in 2010, the key challenge and question is where margins will come in. Aligning supply and demand curves may prove a challenge.

We continue to have a significant asset allocation in Emerging Markets. With monetary policy likely to remain accommodative, we believe that the prospect for growth to surprise on the up-side is greater in the Developing world, and in particular in economies with latent but expanding domestic demand as is evident in places like Brazil and India.

Our **US** exposure stays as an Underweight. The recovery in the broader economy is gaining traction, but the medium term growth trajectory is likely to remain modest given debt constraints on all levels. While the market does have a large share of globally diversified industry leading companies that will benefit from global growth, there are more direct beneficiaries in some Emerging Markets.

We also keep **Europe** at an Underweight. While, *ceteris paribus*, the Eurozone appears to be the cheapest region, structural challenges and financial risks prevent us from being more aggressive. The region faces headwinds of a significantly changing financial sector landscape, a strong currency, and less flexible labor markets, which may limit earnings gains into the recovery.

We retain **Japan** as Underweight. The Japanese market is expected to remain a laggard against a backdrop of moderate cyclical recovery. The corporate sector, with its export orientation, is a leveraged play on the global recovery. But it is a bit like an out-of-the-money option, requiring substantial growth before that leverage kicks in. The policies of the new Democratic Party of Japan (DPJ) government may have negative implications on domestic growth.

We remain Overweight **Latin America**. We continue to view the region as offering the best risk adjusted prospects of any major region. The region remains underpinned by strong domestic demand and yields an abundance of good investment opportunities. We continue to overweight sectors that should benefit from a structural increase in domestic demand.

We also keep **Asia-ex-Japan** at an Overweight. Opportunities in Asia will be aided by the global recovery, with earnings expected to continue to enjoy upgrades. Stock selection is likely to be more critical as valuations offer less upside than before after a strong re-rating. As many of the economies around the region step back from prior stimulus initiatives targeted at boosting domestic demand, we are increasingly looking for opportunities among the export sectors that should benefit from global recovery, and where valuations are more reasonable.

We retain **Canada** and **Australia** as Neutral exposures. Both regions have performed well through the downturn. Given the composition of their markets, which is heavily skewed to the resources and financial services sectors, we view these markets as more late cycle and more deep cyclical. Hence, against the expectation of a moderate economic recovery we are at best Neutral.



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