



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	7.1	23.3	9.1	-32.5
MSCI World	6.2	20.8	6.1	-32.6
MSCI USA	2.9	16.7	3.0	-30.5
MSCI Europe	8.7	25.4	7.3	-37.6
MSCI Japan	8.2	14.4	-0.1	-26.9
MSCI AC Asia ex-Japan	13.0	43.2	35.8	-25.2
MSCI Emerging Markets	14.1	44.8	37.2	-32.2

Returns in Singapore dollars. Source: Bloomberg, 29 May 2009

World equity markets continued to rally strongly in May, in most instances reversing the losses in the early part of the year. Investor sentiment improved notably and investors moved to increase exposure to risk assets including equities. Aggressive fiscal stimulus measures and moves to help stabilise financial markets underpinned this shift in investor confidence. The US stress test helped to remove the fear of the 'unknown', as most banks were reported to have more moderate capital needs than previously feared. While the economy faces continued challenges, there are some signs that business conditions are improving with leading indicators bouncing from lows. We are now in the midst of a relief rally that is re-pricing assets from being at risk of failure to being considered going concerns. While this rally may persist for a period, we are nonetheless remaining more defensive in our positioning, given the lack of clarity over end demand. The timing and shape of a recovery will be heavily influenced by the evolving economic backdrop and corporate earnings. The next major signpost that will influence investor behavior is the mid-year earnings reports and subsequent guidance for 2009 performance. We anticipate a mixed picture, with continued challenges and continued differentiation becoming increasingly evident. 2009 and perhaps even 2010 will likely be a stock picker's market.

The Japan market remains the weak link so far. A sharp decline in industrial activity and trade has weighed heavily on the export oriented sectors, which have historically dominated the market. The recently reported losses at Toyota Motor, the benchmark in the auto sector, underscore the severity of the challenge faced by the industrial sector. European markets have also suffered due to concerns over their financial systems, currency pressure, and investor concerns about contagion from an economically troubled Eastern Europe.

Emerging markets have been the stand-out in terms of performance, up sharply on a monthly basis and also on a year-to-date basis. This is broadly justified as the emerging countries do not face the same challenge to growth and do not have the domestic debt overhang that is evident in the



developed world. There is clear differentiation between developed and developing countries on the issue of both growth and leverage, which is fully warranted.

In the developed regions, the more recent market recovery has seen a sharp outperformance among more cyclical and growth sensitive sectors and companies. Unlike prior cycles, where the consumer provided the signal of a return to confidence, this time it will be the corporate sector that we have to monitor, especially given the level of excess capacity still evident. The duration of this rally remains a question that will only be answered in full with earnings confirmation, and a recovery in investment, which would signal that the monetary easing is translating into end demand, and that business confidence is returning.

## OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Slight Overweight	↑	Policy response has been the most aggressive. The Troubled Asset Relief Program, along with broader liquidity support measures, should help limit the economic fallout and help to stabilise asset prices into 2009. Valuations are now supportive, and relative expectations are low.
Europe	Underweight	–	We see significant economic and earnings risk ahead and continue to adopt a very defensive stance in Europe. We are somewhat concerned that policy response has been slow to adjust to the shift in liquidity and note the high degree of European financials and the risk of ongoing deleveraging.
Asia ex-Japan	Slight Overweight	↑	The sharp deterioration in external factors has led us to slash our expectations for growth in Asia. This, along with continued pressure on asset prices, will be a significant headwind for certain Asian economies. However, domestic fundamentals in Asia are generally on favourable footings, creating some opportunities. While we remain defensive in terms of the type of businesses in which we are invested, we remain slightly overweight.
Japan	Underweight	↓	In the face of softening external demand and falling production levels, the fundamentals for Japan appear challenged. While valuations appear more attractive at the moment, Japan remains a heavily export-oriented market and earnings face significant risks.
Latin America	Overweight	↑	Despite its proximity to the US, Latin America appears to offer the best prospects of any region. Latin America is the least integrated investible region in the global economy with limited trade linkages and modest capital linkages. The region continues to benefit from growth in domestic demand fuelled by rising purchasing power.



We remain in the midst of a global recession that is on a scale not witnessed in decades. Earnings visibility remains poor, and corporate profitability is expected to remain under pressure for some time. While valuations do provide some support, we will need to see evidence that corporate profits can hold up for the recovery to become durable. In the interim, our strategy is to continue to focus on the high quality companies that are well positioned to respond to today's challenges. We are finding good opportunities in virtually all sectors.

Government response to the crisis has been bold and has helped to contain the near-term downside risk to the global economy. However, there are concurrent negative implications embedded in some of the policy responses. First is the rapid build up of debt and aggressive monetary easing, which will likely detract from long term growth prospects and add to financial risk down the road. The second, and perhaps more troubling is the move by Governments to take investment stakes in the private sector in the interest of protecting jobs. This in the long run could increase the temptation of policy makers to adopt protectionist measures in order to appease voters and to believe, under a misguided notion, that they need to preserve value for their investments. If implemented without sufficient discipline, this policy could represent the thin edge of the wedge towards a swing towards protectionism. If this happens, the recovery process would inevitably be derailed.

We retain a modest overweight exposure to the **US**. Expectations in the US have already been lowered significantly. The US Federal Reserve is likely to continue to provide an accommodative monetary stance. Fiscal policy under a new Obama-led administration is likely to be aggressive, with spending targeted in a two-pronged fashion, firstly towards structural objectives of enhancing public infrastructure, and secondly towards enhancing the social safety net, which should stabilise demand. We have positioned our portfolios for a protracted period of sub-par growth, and have built in a margin of safety to contend with the risk of a hard landing.

We keep an underweight position in **Europe** as the valuation argument is not strong enough to mitigate the growing risk to earnings. We see significant need for deleveraging across many of the largest financial institutions in Europe. This will likely be accompanied by an extended period of upward re-pricing of risk for borrowers, which will exert a drag on growth. A sharp deterioration in financial and economic conditions will increase the risk that earning expectations are lowered further.

We continue to overweight in **Latin America**, which appears to offer the best risk-adjusted prospects of any major region. Latin America's trade linkages and exposure to the global slowdown are largely limited, leverage within the region's economies is also modest and external positions are comparatively strong. The region continues to benefit from strong domestic demand, and while growth may moderate a bit, it should continue to yield opportunities for investors.

We remain overweight in **Asia ex-Japan** but remain defensive in terms of sector/stock selection, focused on beneficiaries of domestic demand. Growth is slowing faster than previously feared, credit is being rationed, confidence is being adversely impacted and asset prices are falling sharply. As such, we have adopted an increasingly defensive strategy focused on companies that benefit from sustained growth in domestic demand.



## Market Commentary

June 2009

We remain more cautious on the outlook for **Japan** and remain underweight. Corporate sector profits remain under pressure, particularly among export sectors that are more exposed to discretionary consumer spending. We see significant risk to earnings into 2010 as capping future expectations.

Markets were clearly oversold in the early part of the year, when financing concerns were adversely impacting even sound businesses. Now that financial market conditions have become more normal, markets have re-rated. We expect to remain in an environment of sub-trend growth for some time. The rising tide that lifted all ships is not expected to return for the foreseeable future. It will be increasingly important to pick the right ship to navigate the choppy waters of what will prove to be a protracted recovery. We continue to focus on high-quality bottom-up investments which will perform better in an environment of heightened uncertainty and risk. We continue to sow the seeds today to benefit from recovery in the years ahead.



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