



EQUITIES	1 MTH	3 MTH	YTD	12 MTH
MSCI AC World	1.3	(9.4)	(17.5)	(19.8)
MSCI World	2.0	(8.3)	(16.5)	(19.9)
MSCI USA	4.9	(4.8)	(13.4)	(18.5)
MSCI Europe	(0.7)	(11.9)	(21.6)	(23.0)
MSCI Japan	(0.8)	(10.4)	(14.3)	(23.1)
MSCI AC Asia Ex-Japan	(3.8)	(16.4)	(29.7)	(25.4)
MSCI Emerging Markets	(4.8)	(17.8)	(24.3)	(18.2)

Returns in Singapore Dollars. Source: Bloomberg

World equity markets extended their declines into August, with Emerging Markets falling the most. The US market was the only region to post gains in August. Mounting concerns over the outlook for growth in Europe and Japan, and inflation pressures in Emerging Markets, along with tightening credit conditions weighed heavily on market performance. Investor behaviour continues to be driven more by fear than rationality, fear over the housing market, fear over the growth outlook, and fear of contagion risk. The recently announced support of the Government-Sponsored Mortgage Enterprises (Freddie Mac and Fannie Mae) should help to underscore the fact that central banks will do what is required to ensure that the housing market and other risk asset markets clear in a more orderly fashion. Meanwhile, the US market, thanks to the still weak dollar, is likely to lead the recovery, as earnings among the industrial and technology sectors are showing resilience in the face of more challenging operating conditions.

OUTLOOK AND STRATEGY

	POLICY	CHANGE	COMMENT
US	Slight Overweight	↑	Policy response has been the most aggressive. GSE support measures should help to ensure an orderly clearing process. A weaker dollar is helping export-oriented sectors. Having underperformed for several years, valuations are now supportive, and relative expectations are low.
Europe	Underweight	-	We see greater risks to earnings and have tempered our previously positive view on Europe. We are somewhat concerned that policy response has been slow to adjust to the shift in liquidity and note the increased leverage of European financials and the risk of ongoing deleveraging.
Asia (ex-Japan)	Neutral	↓	The sharp deterioration in external factors has led us to reduce our allocation to Asia. We are concerned that the deterioration in exports will weigh on domestic confidence and pose further risk to earnings expectations.
Japan	Underweight	↓	In the face of softening external demand, it is difficult to overweight Japan. While valuations appear more attractive at the moment, Japan remains a heavily export-oriented market.

We continue to monitor the US housing market, the financial sector and employment trends carefully, given continued downside risk, which may disrupt confidence and end demand. Housing market issues and the need for financial sector deleveraging clearly extend beyond the US to Europe. We remain concerned that tighter financial conditions in Europe will have an adverse impact on economic performance into 2009. The defensive posture in terms of the types of companies that we are targeting prevails, as does our decision to underweight consumer discretionary and mid-cycle industrial companies. We have started to deploy incremental capital to the US. We remained concerned about Europe and are slightly less positive on both Asia ex-Japan, as well as Latin America. Our strategy is to continue to focus on the less cyclical sectors including consumer staples, healthcare and telecommunications.

We have lifted our exposure to the US to Slightly Overweight and may further increase our exposure there. Expectations in the US have already been lowered significantly, and the prospects of downward revisions outside of the housing and consumer discretionary sectors are somewhat contained, with the still weak dollar providing a boost to the export industrial sector. The Fed is likely to continue to provide an accommodative monetary stance should downside risks build.

Continued headwinds in the form of tight credit conditions, declining asset prices, higher debt service costs, and rising savings rates will likely exert downward pressure on medium term growth and represent a risk to our soft landing hypothesis.

In terms of earnings outlook, a mitigating factor for the US corporate sector is the relatively weak US dollar, which is helping to boost exports, realign costs and help corporations mitigate pressures on margins and profits. This is particularly true among the Large Cap segment of the market. However, earnings visibility has clearly diminished and further downgrades are probable. We see heightened risk among the Small Cap segment of the market, as businesses are typically more focused on domestic markets. Valuations do provide some support, given attractive relative earnings yields against bond yields but, ceteris paribus, we focus on quality.

We keep our underweight in **Europe** as wage claims appear to be gaining ground, and the ECB has grown more hawkish. We view the valuation argument as more tenuous, particularly when superimposed against the sharp deterioration in financial market conditions. Weaknesses in the financial system will likely impact both the availability of credit and the real economy. 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.



Market Commentary

September 2008

We have tempered our earlier optimism in **Asia ex-Japan**. Growth appears to be slowing faster than previously feared. As such, we have adopted an increasingly defensive strategy in terms of the type of companies targeted, with domestic demand plays featuring prominently.

We are neutral in **Japan**. Corporate sector profit growth is uninspiring, particularly in the export sectors that are dependent on a robust global economy to drive growth. Whilst Japan has held up as a risk aversion trading market (with earnings that are less susceptible to large downward revisions), we view the medium term earnings growth prospects as uninspired.

From a longer-term perspective, a correction in the US mortgage market is a necessary evil. This correction will create some medium-term challenges for the policy makers, the economy, and the financial markets. Current conditions are negative for the equity markets, and will likely continue to dampen performance for the next couple of quarters. We continue to focus on high-quality bottom-up investments which will perform better in an environment of rising volatility.

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