

Stable crude oil prices, a weaker yen, and expectations of an economic stimulus package for Japan, provided only temporary support for the Japan equity market in August. The TOPIX fell for the third straight month, due to weak US and Japan economic data and also poor Apr-Jun results by domestic companies. Concerns were compounded by news that leading US financial institutions would book more housing loan write-downs in Jul-Sep, and that the Japan real estate company, Urban, had filed for bankruptcy protection from creditors owing to cash flow problems.

EQUITIES - JAPAN	1 MTH	3 MTH	YTD	12 MTH
MSCI Japan	(0.8)	(10.4)	(14.3)	(23.1)
Nikkei 225	0.6	(8.0)	(13.2)	(21.8)
Topix	(0.9)	(10.1)	(13.6)	(22.7)
Jasdaq	(0.0)	(9.4)	(18.3)	(22.6)

Returns in Singapore Dollars. Source: Bloomberg

External developments, such as rising tension over Georgia and the economic slowdown in Europe, further dampened investors' sentiment. The yen weakened to the Y110/US\$ level in the middle of August, but this trend eased through the end of the month as crude oil prices rose again and US financial concerns re-emerged.

The best performers during the month were Mining, Precision Instruments, Electric Power & Gas, Pulp & Paper, and Pharmaceuticals (+3.6%). Among the worst performers August included Other Financial Business, Banks, Steel, Fishery, Agriculture & Forestry, and Wholesale Trade.

OUTLOOK AND STRATEGY

INDEX	POLICY	CHANGE	COMMENT
Financials	Neutral	-	Prefer mega and regional banks to non-banks.
Consumer discretionary	Neutral	-	Consumption indications still weak. Prefer consumer staples.
IT hardware	Neutral	-	Benefits from weakening Yen.
Industrials	Neutral	-	Like companies with exposure to the emerging economies, and relatively more defensive on domestic.
Pharmaceuticals	Overweight	-	Like cash-rich companies with strong drug pipeline. Looking for investment opportunities in the medical equipment space where visibility is better.
Materials	Negative	↓	Concerns about the impact of high energy and commodity prices on margins.

Japanese stocks have fallen sharply, bringing them down to more attractive valuations. The dividend yield of the TSE 1st section for FY08 has risen to 2.02%, with a spread of 56 bps against the 10-year JGB yield of 1.46% (as at 5 September 2008). This should provide support for the market to some extent. However, any meaningful rebound is likely to be capped as earnings momentum and economic indicators for Japan continue to point downwards. The recent resignation of Prime Minister Fukuda has also created political uncertainty, further weighing on sentiment. We maintain our defensive posture in view of a slowdown in global growth, and the lack of evidence of a US economic recovery. We prefer undervalued stocks with the potential to withstand negative macroeconomic pressure.

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