



EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	-4.1	-2.6	-10.1	-4.7
MSCI World	-4.3	-3.2	-10.8	-6.4
MSCI USA	-5.1	-7.2	-9.3	-3.3
MSCI Europe	-4.3	2.7	-15.6	-11.6
MSCI Japan	-3.1	-4.2	-6.9	-13.1
MSCI AC Asia ex-Japan	-1.8	2.0	-4.7	7.4
MSCI Emerging Markets	-2.6	1.3	-5.5	8.6

Returns in Singapore dollars. Source: Bloomberg, 31 August 2010

The rollercoaster for equities continues. After rebounding strongly in July, up 8%, World equity markets, measured by the MSCI AC World Index fell by nearly 4% in August in US dollar terms. Weakening leading indicators and slowing economic activity in the developed world reinforced an already strong de-coupling between the developed and developing world. Market performance reflected this divergence in fundamentals, with Emerging market falling by significantly less than developed. For the year the divergence is even more apparent, with the MSCI World Index down by 0.5% while the MSCI Emerging Market index is up by nearly 16%.

Economic growth continues to slow in the developed world. In the US, second quarter GDP was revised to 1.6%, down sharply from the 3.7% growth posted in the first quarter. In Europe, there are pockets of strength, specifically in Germany, Sweden and Switzerland. However, it is important to note that much of the apparent strength is due to the cyclical recovery in manufacturing and exports. Output is normalizing at levels significantly below pre-crisis levels across the developed world. The gap as much as 15% in Japan and Europe and 7% in the US.

Although we are not in the double dip camp, slower trend growth and a sizeable output gap, suggests a challenging environment for corporate earnings lies ahead. We continue to monitor company results closely for signs of potential cracks, and we have moved up the quality curve significantly in anticipation of wider divergence.



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The fiscal adjustment process warrants close attention. The effects of the UK and German austerity measures will become more evident in early 2011. Meanwhile, the US is grappling with extending the stimulus via tax cut extensions, capital expenditure tax credits, and infrastructure initiatives. When we heard the news of the recently announced \$50bn infrastructure plan, our immediate reaction was that a zero must have been missing. Unfortunately, the fiscal bias is toward contraction, so we are hopeful that the early signs of private sector strengthening continue. Tax withholding receipts, which are a good indicator of job and wage growth have been positive.

Monetary policy remains highly accommodative across the developed world. As we've suggested previously this should continue.

We will continue to monitor the fiscal adjustment process in Europe and the US. Given the tepid recovery, we remain concerned that overly zealous fiscal consolidation could destabilize the recovery. So far there is limited evidence of this, although we would note the recent weakness in jobs data in the US, where private sector jobs additions have not been sufficient to off-set reductions by the public sector.

OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Underweight	↓	The growth outlook for the US economy has turned decidedly more mixed. The employment and consumption data suggests that the overall growth trajectory for the US economy will likely be around a 2 handle rate into 2011, very weak given the extent of the downturn. The good news is that the US corporate sector, the S&P 500 in particular, is in excellent health. None-the-less, we have opted to reduce exposure given challenges on the domestic front and uncertainties on the policy front - Underweight.
Europe	Underweight	–	Leading indicators in Europe have rebounded sharply. And while consensus growth estimates are being raised, Europe will also be lucky to deliver a 2 handle rate growth into 2011. European unemployment has held up better than the US, largely due to the stronger core economies. The outlook for the more distressed parts of Europe remain bleak, and the contagion risk to the broader Eurozone through the currency union and banking system linkages is a real concern. We remain Underweight.
Asia (ex-Japan)	Overweight	–	Growth in Asia is moderating, but remains strong. China's tightening bias continues to pose longer term risks, as strong upward wage adjustments add to cost pressures. We remain more defensive, focused on sectors where pricing power should be stronger. As recent inflations data has shown signs of moderation, our bias toward domestic consumption driven economies was further reinforced. Overweight.



Japan	Underweight	–	While Japanese corporate profits are projected to rebound sharply in the current year and next, core operating performance leaves much to be desired. Recent Yen strength has weighed on exporters, and will likely result in earnings downgrades. Corporate profitability still needs to recover further before we can justify further capital allocation. We are slightly Underweight.
Latin America	Overweight	↑	Latin America remains our preferred region, underpinned by strong domestic growth. Improved inflation data in Brazil brought an end to the tightening cycle. This is a significant positive for domestic demand and corporate earnings. The region continues to offer strong long term investment opportunities for equity investors. We remain Overweight.

In the Developed world, extended debt levels are a significant headwind. Household and public sector deleveraging will be a headwind to growth. While we had been hopeful that business investment picks up, we do not believe that net export growth would be able to fully mitigate domestic de-leveraging headwinds. Our investment strategy, with a bias towards companies that are positioned to sell into higher growth emerging economies, reflects this view.

Industrial activity in the developed world has still not recovered to pre-crisis levels. This raises questions over expectations of a strong recovery in corporate investment. Furthermore, the UK and the Eurozone pose continued risks, especially in the face of market imposed and politically mandated budget reductions. And while expectations are for a cyclical bounce in corporate spending, we anticipate a downward bias to expectations.

The Emerging world continues to grow at a significantly faster pace than the developed. However, the rate of growth is moderating sharply. Recent data from China points to a slowing in industrial activity, while wage pressures remain acute. Investors will have to monitor margins and profitability closely. We continue to focus on domestically driven growth opportunities within Emerging Markets. To gain leverage to the domestic demand growth of emerging markets we have turned to the most under-levered economies. Latin America, Africa, Eastern Europe, India and Indonesia are good examples.

On a positive note, equity valuations are very attractive. Many of the above mentioned risks are already fully discounted by investors. With growth likely to be harder to come by, we continue to focus our investment attentions on identifying the best growth opportunities for investors, bringing us back to emerging markets. However, given the uncertainties over final demand, input costs, wages and taxes, we have moved decidedly up the quality curve.



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